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ENDORSED FILED
SUPERIOR COURT
COUNTY OF SAN FRANCISCO

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DEPARTMENT 212

IN THE SUPERIOR COURT OF THE STATE OF CALIFORNIA

IN AND FOR THE COUNTY OF SAN FRANCISCO

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM,
Plaintiff,

vs.

QWEST COMMUNICATIONS INTERNATIONAL INC.;

SALOMON SMITH BARNEY, INC.; CITIGROUP, INC.; LEHMAN BROTHERS, INC.; BANK OF AMERICA CORPORATION; BANC OF AMERICA SECURITIES, LLC; JP MORGAN CHASE & CO.; JP MORGAN CHASE SECURITIES; MERRILL LYNCH & CO.;

ARTHUR ANDERSEN, LLP; ANDERSEN WORLDWIDE ORGANIZATION; ARTHUR ANDERSEN & CO. SOCIÉTÉ COOPÉRATIVE; and

JOSEPH NACCHIO; PHILIP F. ANSCHUTZ; ROBERT S. WOODRUFF; ROBIN S. SZELIGA; CRAIG R. BARRETT; VINOD KHOSLA; AFSHIN MOHEBBI; and **DOES 1-50,**

Defendants.

Case No. 415546

COMPLAINT

FOR VIOLATIONS OF:

1. **Calif. Corp. Code § 25400 *et seq.*;**
2. **Calif. Bus. & Prof. Code § 17200 *et seq.*;**
3. **Fraud, deceit and concealment;**
4. **Breach of fiduciary duty;**
5. **Violation of § 11 of the Securities Act (against Andersen)**
6. **Violation of § 11 of the Securities Act (against certain Bank Defendants)**
7. **Violation of § 11 of the Securities Act (against certain Individual Defendants)**
8. **Violation of § 15 of the Securities Act**

Amount demanded exceeds $25,000

JURY TRIAL DEMANDED

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Plaintiff California State Teachers' Retirement System ("CalSTRS"), as and for its complaint, alleges as follows upon information and belief based, *inter alia*, upon investigation conducted by Plaintiff and its counsel, except as to those allegations pertaining to Plaintiff personally, which are alleged upon knowledge:

I. NATURE OF THE CASE

1. This action involves fraudulent conduct by telecommunications company Qwest Communications International Inc. ("Qwest" or the "Company"), its directors and officers, and financial professionals that has caused the pension plan of California's teachers, Plaintiff CalSTRS, to lose in excess of $150 million invested in Qwest's equity and debt securities. CalSTRS is the third largest public pension plan in the United States and serves over 715,000 active and retired teachers of California.

2. In financial statements, filings with the United States Securities and Exchange Commission ("SEC"), press releases and other public statements, Defendants represented that Qwest was one of the highest revenue producing telecommunications companies in the world, with highly favorable financial results and prospects. Unbeknownst to CalSTRS, however, Defendants were engaged in a scheme to falsely inflate Qwest's revenues and decrease its expenses so that Qwest would appear more successful than it actually was. The scheme involved, among other things, improperly recognizing revenues from certain multi-year contracts immediately, and recognizing revenues from capacity-swap contracts whose only purpose was to boost revenue.

3. This scheme flourished because of the active participation and advice of all Defendants: Qwest itself, the directors and officers who signed the Registration Statements for the Notes purchased by CalSTRS and made other misrepresentations and omissions in public filings and statements and who knowingly participated in the financial fraud alleged herein; Arthur Andersen LLP that aided in the scheme and that certified Qwest's false financial statements; and

the banking and financial services companies who were directly involved in a knowing scheme to mislead investors.

4. On July 28, 2002, Qwest disclosed that for the years 1999-2001, it had improperly accounted for about 220 transactions worth approximately $1.16 billion. These improprieties, which occurred during 1999, 2000, and 2001, primarily involved Qwest improperly recording Indefeasible Rights of Use (referred to as "IRU") contracts as revenue immediately rather than deferring the revenue over the life of the contract. Since the IRUs gave third companies the right to use Qwest's capacity or fiber for a period of time, generally twenty years, it was not proper for Qwest to record this revenue immediately. Qwest also entered into "swap" or reciprocal transactions with third parties, such as Global Crossing and Enron, where each bought services or products, that had no business purpose, from the other at inflated prices. Qwest stated that it would be restating its financial statements.

5. On October 28, 2002, Qwest made further disclosures in a press release that it would restate $531 million of *previously* recognized revenue because of improper accounting. Qwest stated that it would treat those past sales of IRUs "for cash as operating leases and recognize the revenue from these assets over the life of the IRUs. The company has concluded that its policies and practices for determining the value of the various elements of the fees earned in connection with the sales of optical capacity assets for cash did not support the accounting treatment. As a result, the company concluded that it should defer the $531 million of revenue previously recognized on such sales over the life of the underlying agreements."

6. Due to Defendants' misrepresentations and omissions about Qwest's financial well-being and prospects, CalSTRS purchased Qwest notes and stocks at artificially inflated prices. As Defendants' fraud that inflated Qwest's revenues in

1999, 2000 and 2001 became known, Qwest's stock and bond prices fell significantly, ultimately leaving CalSTRS's investments almost worthless.

II. <u>JURISDICTION AND VENUE</u>

7. Plaintiff CalSTRS purchased Qwest notes and stock in San Francisco, California. Plaintiff CalSTRS is an agent and instrumentality of the State of California, and therefore, is not a citizen of any state. *Moor v. County of Alameda* (1973) 411 U.S. 693.

8. Each Defendant has sufficient minimum contacts with California, is a citizen of California, or otherwise purposefully avails itself of benefits from California or has property in California so as to render the exercise of jurisdiction over it by the California courts consistent with traditional notions of fair play and substantial justice.

9. The amount in controversy exceeds the jurisdictional minimum of this Court.

10. This action is not preempted by the federal Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), as this action is <u>not</u> a class action and is brought by a single Plaintiff seeking damages. Furthermore, SLUSA expressly provides that, notwithstanding the other provisions of the Act, a state pension plan such as CalSTRS may maintain a state court action on its own behalf. *See* 15 U.S.C. § 77p(d)(2); 15 U.S.C. § 78bb(f)(3)(b).

11. The claims are brought under California law, Cal. Corporations Code § 25400 *et seq.*, which prohibits knowing or intentionally false or misleading statements in connection with the sale of a security, under Cal. Bus. & Prof. Code § 17200 *et seq.*, and under California common law. The claims are also brought under section 11 of the Securities Act, 15 U.S.C. § 77k, and § 15 of the Securities Act, 15 U.S.C. § 77o. California courts have jurisdiction over claims under § 11 and § 15 of the Securities Act pursuant to 15 U.S.C. § 77v(a), and such claims are not subject to removal.

III. THE PARTIES

A. Plaintiff

12. Plaintiff CalSTRS is the third largest public pension fund in the United States. CalSTRS was established by the California Legislature pursuant to California Education Code Section 22000 *et seq*. CalSTRS administers retirement, disability and survivor benefits for California's public school educators in grades kindergarten through community college. CalSTRS serves approximately 715,000 members and benefit recipients. CalSTRS invests plan members' funds in a variety of investments, including equity and debt securities issued by publicly traded companies. CalSTRS is administered by a 12-member Retirement Board and has 540 employees.

13. CalSTRS engaged in the following transactions in Qwest's 7.9% Notes due 2010 ("7.9% Notes"); 7.25% Notes due 2011 ("7.25% Notes"); 7.75% Notes due 2031 ("7.75% Notes); and 7% Notes offered October 30, 2001, due 2009 ("7% Notes"):

> CalSTRS purchased 1 million par of the 7.9% Notes on August 16, 2000 at a unit price of 99.79 from The Williams Capital Group.
>
> CalSTRS purchased 30 million par of the 7.9% Notes on August 16, 2000 at a unit price of 99.79 from Salomon Smith Barney.
>
> CalSTRS purchased 30 million par of the 7.9% Notes on August 16, 2000 at a unit price of 99.79 from Salomon Smith Barney.
>
> CalSTRS purchased 15 million par of the 7.9% Notes on October 24, 2000 at a unit price of 102.03 from HSBC Securities.
>
> CalSTRS purchased 4 million par of the 7.25% Notes on February 7, 2001 at a unit price of 99.99 from The Williams Capital Group.
>
> CalSTRS purchased 20 million par of the 7.25% Notes on February 7, 2001 at a unit price of 99.99 from JP Morgan Securities.

CalSTRS purchased 3 million par of the 7.75% Notes on February 7, 2001 at a unit price of 99.70 from The Williams Capital Group.

CalSTRS purchased 10 million par of the 7.75% Notes on February 7, 2001 at a unit price of 99.70 from JP Morgan Securities.

On March 19, 2001, through HSBC, CalSTRS sold 25 million par of the 7.9% Notes for a net gain of $1,347,162.85.

On April 12, 2001, pursuant to a registration statement filed with the SEC, CalSTRS exchanged 51 million of the previously purchased 7.9% Notes at a unit price of 100.23.

CalSTRS purchased 5 million par of the 7.0% Notes on August 21, 2001 at a unit price of 99.52 from HSBC Securities.

CalSTRS purchased 5 million par of the 7.0% Notes on August 21, 2001 at a unit price of 99.76 from HSBC Securities.

On August 27, 2001, CalSTRS, pursuant to a registration statement filed with the SEC, CalSTRS exchanged 24 million of the previously purchased 7.25% Notes at a unit price of 99.99.

On August 27, 2001, pursuant to a registration statement filed with the SEC, CalSTRS exchanged 13 million of the previously purchased 7.75% Notes at a unit price of 99.70.

CalSTRS purchased 10 million par of the 7.75% Notes on October 5, 2001 at a unit price of 98.06 from Barclays Capital.

CalSTRS purchased 15 million par of the 7.75% Notes on October 5, 2001 at a unit price of 98.35 from Merrill Lynch.

On December 7, 2001, CalSTRS sold (a) 5 million par of the 7.75% notes through HSBC Securities, at a loss of $323,252.25; (b) 10 million par of the same notes through UBS Warburg at a loss of $649,504.53; (c) 8 million par of the 7.75% Notes, through Lehman Brothers at a loss of $611,063.62.

On December 13, 2001, pursuant to a registration statement filed with the SEC, CalSTRS exchanged 10 million of the previously purchased 7.0% Notes at a unit price of 99.66.

On May 21, 2002, CalSTRS sold 10 million par of the 7.25% notes through Goldman Sachs, at a loss of $2,699,773.70.

On June 19, 2002, also through Goldman Sachs, CalSTRS sold 5 million par of the 7.9% Notes at a unit price of 77.00, for a loss of $1,161,114.97.

On June 20, 2002, through Deutsche Bank Securities CalSTRS sold 5 million par of the 7.9% Notes at a unit price of 75.75 for a loss of $1,223,612.28.

On June 24, 2002, through Credit Suisse First Boston, CalSTRS sold 5 million par of the 7.9% Notes at a unit price of 74.00 for a loss of $1,311,106.91.

On June 25, 2002, through Salomon Smith Barney, CalSTRS sold 5 million par of the 7.9% Notes, at a unit price of 74.50, for a loss of $1,286,104.22.

On June 27, 2002, CalSTRS sold its remaining position through Deutsche Bank Securities, as follows:

- CalSTRS sold 21 million par of the 7.9% Notes, at a 50.00 unit price, for a loss of $10,546,592.57.
- CalSTRS sold 10 million par of the 7.9% Notes, at a unit price of 51.13, for a loss of $4,909,686.93.
- CalSTRS sold the remaining 14 million par of the 7.25% Notes, at a unit price of 51.50, for a loss of $6,789,685.97.
- CalSTRS sold the remaining 15 million par of the 7.75% Notes, at a unit price of 49.00, for a loss of $7,463,168.72.
- CalSTRS sold the remaining 10 million par of the 7.0% Notes, at a unit price of 52.00, for a loss of $4,768,822.82.

14. Starting in 1998, CalSTRS also invested over $100 million in Qwest stock in reliance on Defendants' representations and omissions. As a result of Defendants' fraud, CalSTRS has suffered enormous losses. As of October 31, 2002, CalSTRS had a total net loss of approximately $150 million from its purchases of Qwest's notes and stock.

B. **Defendants**

1. Qwest

15. Qwest Communications International Inc. is a corporation organized under the laws of Delaware and has its principal executive offices in Denver, Colorado. Qwest provides local telecommunications and directory services in the 14-state local service area of Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington and Wyoming. Qwest also provides broadband communications services globally. Qwest first filed as a corporation with the California Secretary of State on January 30, 1989. Qwest subsidiaries or business divisions that are also on file with the California Secretary of State and the date of filings include: Qwest Business & Government Services Inc., August 30, 1984; Qwest Government Services Inc., May 11, 1989; Qwest Interprise America Inc., January 2, 1996; Qwest Long Distance Inc., May 13, 1996; and Qwest Internet Solutions Inc., February 20, 1998.

2. The Individual Defendants

16. Defendant Joseph P. Nacchio ("Nacchio") was the Chief Executive Officer of Qwest from January 1997 to June 17, 2002, the cochairman of the Company's board of directors from February 1997 to June 17, 2002, and was a member of the board's Executive Committee. Defendant Nacchio sold over 5 million shares of his holdings of Qwest stock, realizing proceeds of over $228 million.

17. Defendant Philip F. Anschutz ("Anschutz") is the founder of Qwest and was the cochairman of the Company's board of directors from February 1997 to June 17, 2002 and a member of the board's Executive Committee. He remains a director and the chairman of the executive committee of the board. Defendant Anschutz, Qwest's largest shareholder, sold over 40 million shares of his holdings of Qwest stock for total proceeds of over $1.9 billion. Anschutz is one of the ten

wealthiest people in the United States. Before he began Qwest, he had made billions of dollars from oil, ranches, real estate, and railroads. He also is the chairman of The Anschutz Corporation and Anschutz Co. and a director of the Union Pacific Corporation. Anschutz owns the largest movie theater chain in the United States and 16 sports teams, including the Los Angeles Kings, a 30% interest in the Los Angeles Lakers, and operating rights to four Major League Soccer clubs.

18. Defendant Robert S. Woodruff ("Woodruff") was a director, and Executive Vice President – Finance, Chief Financial Officer, and Treasurer of Qwest from 1997 until 2001. He had joined Qwest in 1994 as the Executive Vice President – Finance, Chief Financial Officer and Treasurer, and became a Director in 1996. Prior to joining Qwest, he was a partner at Coopers & Lybrand, where he specialized in communications companies. He signed Qwest's reports to the SEC on Forms 10-Q and 10-K, and its June 21, 1999, September 17, 1999, and July 7, 2000 registration statements for securities offerings. He realized proceeds of more than $45 million from sales of his holdings of Qwest stock, and earned salaries and bonuses of over $500,000 per year.

19. Defendant Robin Szeliga ("Szeliga") joined Qwest in 1997. Defendant Szeliga was the Chief Financial Officer of Qwest from April 2001 through July 2002, the Interim Chief Financial Officer from March 2001 through April 2001, and has been an Executive Vice President from July 2002 to the present. She was close to Defendant Nacchio, who had the office next to hers, and they spoke daily about the Company. Defendant Szeliga sold at least 10,000 shares of her holdings of Qwest stock, realizing proceeds of $410,000.

20. Defendant Craig R. Barrett ("Barrett"), Chief Executive Officer of Intel Corporation and a member of the board of directors of Intel, has been a director of Qwest since June 2000. He serves on the Executive Committee and Technology Review Committee. As stated by Qwest in an its amended report on

Form 10-K for 2001, filed November 22, 2002: "As previously disclosed, Craig R. Barrett, a director of Qwest, is chief executive officer of Intel Corporation. From time to time, Intel or entities controlled by it, have taken and may take positions in companies with which we may conduct business. Typical examples of such companies in which Intel has invested in the past include Covad Communications Group, Inc., Raindance Communications, Inc., Telera Corp. and Williams Communications Group Inc. Intel no longer has investments in any of these example companies."

21. Defendant Vinod Khosla ("Khosla") is one of the founders of Sun Microsystems and its former Chief Executive Officer and a partner in the venture capitalist firm of Kleiner, Perkins, Caufield and Byers, and has been a director of Qwest since June 1998. When Khosla joined the Qwest board, Defendant Nacchio represented that Khosla was the "pioneer of open systems, commercial RISC processors and IP adoption," and that he "brings to Qwest an invaluable amount of business and technical knowledge and the understanding of Silicon Valley, which will be instrumental as Qwest moves forward with its multimedia IP strategy." Khosla has served as a member of Qwest's Audit Committee and Technology Review Committee. Reputed to be a cogent strategic thinker, Kholsa has provided strategic advice to Qwest and created relationships between Qwest and potential customers, and has been a strong and vocal supporter of Nacchio and his policies. As stated by Qwest in its amended report on Form 10-K for 2001, filed November 22, 2002: "As previously disclosed, Vinod Khosla, a director of Qwest, is a general partner of Kleiner, Perkins, Caufield and Byers ('KPCB'), a venture capital firm. From time to time, KPCB or entities controlled by it have taken and may take positions (including control positions) in, and have designated and may designate persons (including Mr. Khosla) on the boards of, companies with which we may conduct business. These companies include Centrata Inc., Corvis Corporation, Juniper Networks, Inc. and OnFiber Communications, Inc."

22. Defendant Afshin Mohebbi ("Mohebbi") has been the President and Chief Operating Officer of Qwest from April 2001 to the present, President of Worldwide Operations from June 2000 to April 2001, and was previously President and Chief Operating Officer from May 1999 to June 2000.

23. The Defendants listed in paragraphs 16-22 above are referred to in this Complaint as the "Individual Defendants."

24. The Individual Defendants listed below signed the Registration Statements for the Qwest note offerings indicated below, in which Plaintiff invested:

Directors and Officers	**Registration Statements**			
	7.9% Notes	**7.25% Notes**	**7.75% Notes**	**7% Notes**
Joseph P. Nacchio	X	X	X	X
Phillip F. Anschutz	X	X	X	X
Robert S. Woodruff	X			
Robin Szeliga		X	X	X
Craig R. Barrett	X	X	X	X
Vinod Khosla	X	X	X	X

3. The Bank Defendants

25. Defendant Salomon Smith Barney Inc. ("Salomon"), a corporation doing business in California, is the second largest retail brokerage firm in the United States providing brokerage, investment-banking and asset management services to corporations, governments and individuals around the world. Salomon is a subsidiary of Defendant CitiGroup, Inc. ("CitiGroup"), a financial services company. Between January 1998 and July 2001, Salomon advised Qwest on about 18 investment banking deals which earned Salomon over $37 million in fees. Salomon was an underwriter of the 7.9% Note offering, which was offered on January 17, 2001.

26. Defendant CitiGroup, Inc. is the parent of Salomon and an international financial institution doing business in California. CitiGroup loaned millions of dollars to Qwest. There is a unity of interest and ownership between CitiGroup and Salomon such that the acts of the one are for the benefit and can be imputed as the acts of the other. Citigroup and Salomon are referred to herein collectively as “Salomon.”

27. Defendant Lehman Brothers, Inc. (“Lehman”) is a global investment bank with offices around the world and in California. It provides research, distribution, and financing services. Lehman was an underwriter of the 7.9% Note offering, which was offered on January 17, 2001. Lehman was also an underwriter for the 7% Note offering, which was offered on October 30, 2001.

28. Defendant Banc of America Securities LLC (“Banc of America”), a limited liability company doing business in California with a principal place of business in San Francisco, California, is a full-service investment bank and brokerage firm. It is a subsidiary of Bank of America Corporation (“Bank of America”), and there is a unity of interest and ownership between Banc of America and Bank of America, and its predecessors, such that the acts of the one are for the benefit and can be imputed as the acts of the other. Banc of America was an underwriter of the 7.25% Note offering, which was offered on July 12, 2001.

29. Defendant Bank of America, which does business in California, is the successor to Nations Bank and is the parent of Banc of America. There is a unity of interest and ownership between Banc of America and Bank of America, and its predecessors, such that the acts of the one are for the benefit and can be imputed as the acts of the other. Bank of America is one of the world’s leading financial services companies. Bank of America (and its predecessor Nations Bank) loaned millions of dollars to Qwest.

30. Defendant J.P. Morgan Chase & Co. ("Morgan Chase") is a leading global financial services firm with operations in more than 50 countries and in California. Through its subsidiaries and divisions (including Defendant J.P. Morgan Securities), it provides commercial, financial, advisory and investment banking services. Morgan Chase began as a company on December 31, 2000 as a result of a merger between Chase Manhattan Corporation and J.P. Morgan & Co., Inc. There is a unity of interest and ownership between Morgan Chase, and its predecessors, and J.P. Morgan Securities such that the acts of the one are for the benefit and can be imputed as the acts of the other. Morgan Chase loaned millions of dollars to Qwest.

31. Defendant J.P. Morgan Securities ("Morgan Securities") is an affiliate of Morgan Chase and does business in California. There is a unity of interest and ownership between Morgan Chase, and its predecessors, and Morgan Securities such that the acts of the one are for the benefit and can be imputed as the acts of the other. Morgan Securities is a global leader in underwriting. Morgan Securities was an underwriter of the 7.25% Note offering, which was offered on July 12, 2001.

32. Defendant Merrill Lynch & Co. ("Merrill") is one of the world's largest lending financial management and advisory companies, with offices in 37 countries, and in California, and total client assets of approximately $1.3 trillion. Merrill was an underwriter of the 7% Note offering, which was offered on October 30, 2001. Merrill also was a purportedly independent analyst touting Qwest's stock. Merrill has just entered into a $100 million settlement with the State of New York and 48 other states because its purportedly independent analysts were not really independent, but instead touted the firm's investment banking clients, even when the companies were dubious investments, in order to earn investment banking fees.

33. The Defendants listed in paragraphs 25-32 above are referred to in this Complaint as the "Bank Defendants."

4. Andersen

34. Defendant Arthur Andersen LLP ("Arthur Andersen") is an international accounting limited liability partnership doing business in California. Arthur Andersen was the outside auditor for Qwest for the years 1999-2002, and also provided non-auditor professional services to Qwest and its subsidiaries and affiliates. For the years 1999, 2000 and 2001, it provided unqualified audit opinions on Qwest's financial statements, and it reviewed interim financial statements. Its opinions certifying Qwest's financial statements were included in the Registration Statements for the Note offerings and Andersen affirmatively consented to its opinions being included in the public offering documents. In 2000 and 2001, Qwest paid Arthur Andersen $2.45 million for its audits and $17.2 million in non-audit fees.

35. Arthur Andersen operates as an integrated entity throughout the world, and is composed of Defendant Andersen Worldwide Organization ("AWO"); the AWO member firms; the partners of the firms; and Defendant Arthur Andersen & Co. Société Coopérative ("AWSC"), which acts as the "umbrella" entity for the organization, the member firms, and the partners. AWO, AWSC, and Arthur Andersen set the policies and procedures governing all member firms and offices worldwide.

36. All of these Defendants constitute a single, unified business entity. The partners in each of the AWO member firms and local offices are partners of the worldwide Arthur Andersen entities. All of the firms share revenues and profits. The worldwide companies establish standards for the operations of all of the other Andersen entities. The operations of the worldwide entities are integrated as a single unit.

37. Except where otherwise indicated, the entities listed in paragraphs 34-36 above are referred to in this Complaint as "Andersen."

5. Doe Defendants

38. Except as described herein, Plaintiff is ignorant of the true names of Defendants sued as Does 1 through 50 inclusive and, therefore, sues these Defendants by such fictitious names. Plaintiff will seek leave of the Court to amend this Complaint to allege their true names and capacities when they are ascertained.

39. Plaintiff alleges that each of these Doe Defendants is responsible in some manner for the acts and occurrences alleged herein, and that Plaintiff's damages were caused by such Doe Defendants.

6. Agents and Co-Actors

40. At all relevant times, each Defendant was and is the agent of each of the remaining Defendants, and in doing the acts alleged herein, was acting within the course and scope of such agency. Each Defendant ratified and/or authorized the wrongful acts of each of the Defendants.

41. Defendants, and each of them, are individually sued as participants and as aiders and abettors in the improper acts, plans, schemes, and transactions, to induce Plaintiff to purchase the stock that is the subject of this Complaint.

42. Defendants, and each of them, have participated as members of the fraud or acted with or in furtherance of it, or aided or assisted in carrying out its purposes alleged in this Complaint, and have performed acts and made statements in furtherance of the violations and conspiracy.

7. Unnamed Participants

43. Numerous individuals and entities participated actively during the course of and in furtherance of the conspiracy to recognize false revenues for Qwest, and conceal such information from the public. There was a conspiracy and many acts were done in the course of and in furtherance of the conspiracy by

statements, conduct, and intent to defraud. The individuals and entities acted in concert by joint ventures and by acting as agents for principals, in order to advance the objectives of the conspiracy to increase false revenues. The acts were intended to promote the conspiratorial objectives.

IV. BACKGROUND OF QWEST AND ITS REPORTED FINANCIAL PERFORMANCE

A. Qwest's Formation

44. In 1995, billionaire investor and Defendant Philip Anschutz started Qwest by combining SP Telecom, a telecommunications subsidiary of the Southern Pacific Railroad Corporation – then owned by Anschutz – with Qwest Corporation, a small Dallas-based digital microwave firm. The network on which the telecommunications company was based consisted of fiber-optic cables laid along the Southern Pacific Railroad right-of-way.

B. Qwest's IPO

45. On June 27, 1997, Qwest went public at $5.50 per share, adjusted for stock splits ($125 million in 1995 to $696 million in 1997).

C. Qwest Grows Through Mergers and Acquisitions

46. Qwest then engaged in a series of mergers and acquisitions that made it one of the largest telecommunications companies in the world. The Telecommunications Act of 1996, which sought to bring about competition across various telecommunications markets, helped Qwest grow and enter new fields by reducing barriers to competition in the telephone, broadcast, cable, satellite and utility industries.

47. In 1998, Qwest acquired LCI International, Icon CMT Corp., EUnet International, Limited, and Phoenix Network Inc. These acquisitions allowed Qwest to report $4 billion in combined revenues.

48. On June 13, 1999, Qwest issued a press release announcing a key merger with U S West, a 120-year old telecommunications giant that served 14 states throughout the West. The press release stated:

> DENVER, June 13, 1999 – Qwest Communications International Inc. (Nasdaq: QWST) today offered to acquire U S WEST, Inc. (NYSE: USW) and Frontier Corporation (NYSE: FRO) in separate transactions for a total of $55 billion in cash and equity and $11.4 billion in assumed debt. The proposed transactions will enable Qwest to bring innovative Internet communication services and accelerate the delivery of broadband connectivity to more than 31 million consumers and businesses across the United States. The new company will have a combined equity market capitalization of $87 billion, be headquartered in Denver and employ approximately 71,000 people.
>
> "With the proposed acquisitions of U S WEST and Frontier, we take the next logical step in accelerating our delivery of Internet-based, broadband communications services to customers," said Qwest Chairman and CEO Joseph P. Nacchio. "The Internet communications powerhouse we intend to create will bring together the three companies' network infrastructure, applications and services, as well as their customer distribution channels, to further strengthen Qwest's worldwide, first-to-market leadership position and fuel our continued growth."
>
> Qwest said the proposed Qwest/U S WEST/Frontier combination will generate many strategic and customer benefits. These include:
>
> > creation of a combined enterprise with $22 billion of pro forma year-2000 revenue and $8 billion of pro forma year-2000 EBITDA (earnings before interest, taxes, depreciation and amortization); accelerated imple-mentation of Qwest's growth strategy, including deployment of its industry-leading Internet platform and local broadband connectivity services;
> >
> > enhanced Qwest leadership in value-added services through 19 combined CyberCenters, strategic alliances and network facilities; and
> >
> > financial and operational scale and scope through lower unit costs achieved by serving an expanding base of more than

> 31 million customers, including multinational corporations.
>
> Qwest expects the combined enterprise to realize total synergies of approximately $14 billion through the year 2005 . . . .

49. The press release also said that Qwest "expects the combination to increase Qwest's earnings per share in the first year following completion of the U S West transaction, and to be increasingly accretive thereafter." The press release was incorporated into Qwest's June 14, 1999 Form 8-K and June 21, 1999 registration statement.

50. The next month, in July 1999, Qwest and U S West entered into a stock exchange and Plan of Merger. U S West shareholders were to receive Qwest stock worth $69 per share. In an effort to protect U S West shareholders, a "collar" was put on the price of Qwest stock, which would force Qwest to pay cash if the price of the Qwest stock fell below $38.50 at the consummation of the merger. Furthermore, if Qwest's stock price fell below $22.00, U S West had the right to terminate the deal.

51. On September 17, 1999, Defendant Nacchio signed, on behalf of all the directors, a Schedule 14A proxy statement, asking Qwest shareholders to approve the U S West merger. The proxy statement stated in part:

> As you know, Qwest Communications entered into a definitive merger agreement with U S WEST, Inc. on July 18th. This creates a powerful, new $65 billion global broadband Internet communications company with approximately three million fiber miles of network worldwide. When the merger completes in mid-2000, the combined company is expected to have pro forma annual revenue of $18.5 billion and earnings before interest, taxes, depreciation and amortization (EBITDA) of $7.4 billion. We expect to bring together Qwest's advanced network and broadband Internet service capability with U S WEST's innovative local communications and broadband Internet access capability to form the benchmark large-capitalization growth company in the Internet/communications sector for the new millennium.
>
> . . . .

> The linkage with U S WEST will bring about significant economies of scale as well as meaningful cost savings attained through the avoidance or elimination of duplicate operating costs and capital expenditures, and more efficiently handled procurement and selling, general and administrative functions.
>
> Combining these companies will result in a large cap growth company. Scale, scope, revenue, EBITDA and shareholder value are all expected to significantly grow after U S WEST merges with Qwest. The projected annual revenue growth rate is estimated between 15 and 17 percent, while the anticipated annual EBITDA growth is approximately 20 percent, after Qwest receives approval to provide interLATA long distance service throughout the U S WEST region. Your Qwest Board of Directors believes that the merger is in the best interests of Qwest and its shareholders. We unanimously recommend a vote FOR approval of the merger agreement.

52. In November 1999, U S West and Qwest shareholders overwhelmingly approved the merger, but had to wait for regulatory approval before the deal could be finalized. In June 2000, the merger closed.

53. In a June 30, 2000 press release, Qwest announced it had completed the merger with U S West, stating:

> "During the past three years Qwest has become one of the fastest growing Internet communications companies in the world, solidifying Qwest's position as the third-largest carrier of Internet traffic. The new Qwest will have the scale, scope and growth characteristics to deliver more value for shareowners and to continue to lead the industry in the delivery of innovative applications and services," said Joseph P Nacchio, who will continue to be Qwest's chairman and CEO.

54. Qwest did not have to pay extra cash to complete the merger, as its stock price was higher than the minimums in the merger agreement. As a result of the merger, Qwest had over $19 billion in debt.

D. **<u>Qwest's Financial Statements Appeared To Show A Successful, Growing Company, Which Securities Analysts Touted</u>**

55. Qwest's merger strategy appeared to be successful. The financial information which it reported to the public showed a company with increasing

revenues. In 1999 and 2000, Qwest ranked sixth in Deloitte & Touche's Fast 50 Colorado technology companies with five-year growth rates of more than 3000 percent. Its stock was highly touted by securities analysts. In 2001, Qwest ranked second, with growth in excess of 7,000 percent. The analysts who tracked Qwest, including Bank Defendants herein, recommended Qwest as a good investment.

1. Financial Statements Must Be Prepared According to GAAP

56. As a publicly traded company, Qwest was required to file reports, including financial statements, with the SEC. The SEC requires that these financial statements be prepared according to Generally Accepted Accounting Principles ("GAAP"). *See* Regulation, S-X, 17 C.F.R. § 210.01(a)(1) (annual and quarterly financial statements filed with the SEC must comply with GAAP). GAAP are recognized and used by the accounting profession to define acceptable accounting practices at a particular time. Statements of Financial Accounting Standards ("FAS") are the highest authority in GAAP and are created by the Financial Accounting Standards Board ("FASB"). GAAP include other authoritative pronouncements, including Accounting Principles Board Opinions ("APB") and Statements of Position ("SOP") of the American Institute of Certified Public Accountants ("AICPA").

57. If SEC filings do not comply with GAAP, they are presumed to be misleading and inaccurate, despite footnote or other disclosures.

58. The financial statements and other information in Qwest's filings with the SEC, press releases and other public statements reported rapidly increasing revenues and other favorable results. These reported results were materially false or misleading, however, and the financial statements violated GAAP.

2. Qwest's Reported Results For 1999

59. On April 21, 1999, Qwest issued a press release announcing its results for the first quarter of 1999, ended March 31, 1999. The release stated:

Qwest Reports Strong First Quarter 1999 Results With Record Revenue and EBITDA

Denver, April 21, 1999 – Qwest Communications International Inc. today reported a strong first quarter 1999 results reflecting the company's continued rapid growth, momentum and success in winning large, high-profile business accounts. Qwest exceeded the consensus of analysts' earnings estimates.

. . . .

[C]ommunications services revenue for the quarter grew 1,600 percent from $42.6 million to $737.2 million, while total revenue grew five-fold over the first quarter of 1998 from $177.1 million to $878.4 million. Total EBITDA grew 33-fold for the quarter from $4.5 million to $155.4 million compared to the same period last year.

For the three months ending March 31, 1999, pro forma communications services revenue grew to $737.2 million, a 36 percent increase over the same period in 1998. Total revenue was $878.4 million, a 30 percent increase over pro forma revenue for the same period in the previous year. As a result of new service offerings and aggressive customer acquisition efforts, Internet and data communications services continued to post impressive gains and grew by more than 100 percent over 1998. Total EBITDA grew to $155.4 million while communications services EBITDA increased to $100.7 million, representing growth of 95 percent and 98 percent respectively over the same period in 1998. The company reported earnings of $4.8 million, or $0.01 per share, compared to a pro forma loss of (20.5) million or ($0.06) loss per share for the comparable period.

Commenting on the quarter, Qwest Chairman and CEO Joseph P. Nacchio said, "We're extremely pleased with the strong first quarter operational results and the progress across all aspects of our business. Our leading-edge technology and services are in high demand and during the quarter we took critical steps in providing end-to-end networking solutions to our customers."

On a sequential basis, Qwest reported double-digit growth in communications services revenue while communications EBITDA was up more than 30 percent from the fourth quarter of 1998.

"Our quarterly results reflect Qwest's continued momentum and execution while investing for future growth," said Robert S. Woodruff, Qwest executive vice president and chief financial officer. "Our strong revenue growth along with the continued improved gross

> margins and selling, general and administrative cost efficiencies, further strengthen our financial position."

60. On May 13, 1999, Qwest filed with the SEC its quarterly report on Form 10-Q ("10-Q") for the first quarter of 1999. Among other things, the 10-Q reported the financial results claimed in Qwest's April 21, 1999 press release.

61. On June 21, 1999, Qwest filed a registration statement and prospectus for the issuance of 897,907,706 shares of Qwest common stock, required to fund its stock purchase of U S West (later amendments increased the issue). The registration statement, as amended on August 13, 1999, September 17, 1999, and December 27, 1999, incorporated Qwest's consolidated financial statements for each of the three years ending with December 31, 1998; its annual report with the SEC on Form 10-K ("10-K") for the year ended December 31, 1998; its 10-Q for the quarter ended March 31, 1999, its current reports on Form 8-K ("8-K") filed on January 14, 1999, April 27, 1999, April 28, 1999, June 14, 1999 and June 18, 1999; and all documents subsequently filed with the SEC "between the date of this joint proxy statement/prospectus and the date of the meetings." The registration statement was signed by Defendants Nacchio, Woodruff and others and was filed with the signed consent of Defendant Andersen as independent public accountant.

62. On June 21, 1999, Qwest filed an 8-K with the SEC which emphasized the value of the proposed merger with U S West, and attached a letter by Defendant Nacchio to Solomon Trujillo, CEO of U S West, expressly endorsing estimates by some analysts that Qwest's stock offer to U S West stockholders would be worth $98 per share:

> As you may know, some analysts estimate that our offer is worth $98.00 for each U S WEST share, based upon the expected synergies of a combined Qwest/U S WEST/Frontier, our anticipated growth rate and the multiples accorded similarly situated companies. We attach a recent DLJ research analysts' report which supports that conclusion.

63. On June 28, 1999, Defendant Banc of America reported that Qwest revised its bid for U S West and Frontier Corporation. "The combination would increase the number of local markets served by Qwest to 75 from 40, and would create a telecommunications powerhouse. . . We believe the combined Qwest/ U S West/Frontier corporate entity would be an investment grade credit."

64. On July 19, 1999, Defendant Banc of America rated Qwest a "Buy" and stated that the "Merger with U S West creates an Advanced Communications Powerhouse – Reiterate Buy and Price Target of $53."

65. On July 20, 1999, Qwest filed an 8-K incorporating a July 18, 1999 Company press release that made claims about the U S West merger's purported financial benefits, including a five-and-a-half year "revenue synergy" of $12 billion:

> Mr. Nacchio said, "This transaction positions Qwest to be the benchmark, large-cap growth company in the new millennium. Together we will have the scale, scope and growth characteristics to deliver greater long-term value for our shareowners."
>
> "We will achieve our targets by giving customers more choice and superior service, bringing competition and the best in telecommunications services to the marketplace. In addition, we will move rapidly to achieve the necessary freedoms to offer long-distance service to all of our customers," Mr. Nacchio said.
>
> . . . .
>
> Qwest and U S WEST expect the combined company to have a compounded average annual revenue growth rate of approximately 15-17 percent, and a targeted compounded annual EBITDA growth rate of 20 percent, in each case for the period 2000 through 2005.
>
> The combined company expects to realize revenue synergy of $12 billion over a five-and-one-half-year period after closing. In addition, the combined company expects to achieve cost savings of $4.4 billion, and capital-expenditure synergies in excess of $2 billion over the period.

66. On September 15, 1999, Defendant Banc of America published a Telecom Update detailing the proposed acquisition of U S West, Inc. and

expressed its anticipation that Qwest would be upgraded concurrent with the consummation of the merger.

67. On October 27, 1999, Qwest issued a press release announcing its results for the third quarter of 1999, ended September 30, 1999, including claimed quarterly revenue of over $1 billion. The release stated:

> Denver, October 27, 1999 – Qwest Communications International Inc. (Nasdaq: QWST), the broadband Internet communications company, today announced that for the first time the company has recorded revenue for a quarter in excess of one billion dollars. For the tenth consecutive quarter the company met or exceeded the consensus of analysts' estimates.
>
> The $1.02 billion in total revenue for the quarter reflects a 26 percent increase over the same period in 1998, while communications services revenue grew 69 percent.
>
> Total EBITDA was up 62 percent to $190.5 million compared to the third quarter of 1993, while communications services EBITDA increased more than 250 percent. Excluding one-time costs of $25.0 million directly related to the pending merger with U S WEST, Qwest reported net earnings of $19.8 million, or $0.03 per diluted share, compared to a pro forma net loss of ($0.02) per share during the same period in 1998.
>
> Including the merger-related costs, Qwest reported a net loss of $1.8 million, or ($0.00) per share, compared to a net loss of ($0.01) per share a year ago.
>
> Commenting on the quarter, Qwest Chairman and CEO Joseph P. Nacchio said, "Reaching a billion dollars in revenue for the quarter is a major achievement – and a significant milestone for the company. We've said from the beginning that we are creating a growth company and our results clearly show the steps we've taken – building a next-generation network, acquiring strategic assets and capabilities, creating alliances to build advanced applications on our network, and rapidly growing our Internet and data business segment. We continue to see the payoff and the potential in what we've created."

68. The release also quoted Defendant Woodruff as stating, "The results for the third quarter demonstrate Qwest's ability to drive strong revenue and EBITDA growth while making the necessary investments for the future."

69. On February 2, 2000, Qwest issued a press release announcing "record revenue" and other results for the year ended December 31, 1999. In the release, Defendant Woodruff represented that "strong revenue and EBITDA growth" would continue through 2000, "led by the demand for Qwest's Internet-based applications and services." The press release also stated:

> Denver, February 2, 2000 – Qwest Communications International Inc. (NYSE: Q), the broadband Internet communications company, today announced record revenue and earning before interest, taxes, depreciation and amortization (EBITDA) for the fourth quarter and year-end 1999. For the eleventh consecutive quarter Qwest has met or exceeded the consensus of analysts' estimates. The $1.16 billion in total reported revenue for the quarter reflects a 34 percent increase from the $865.1 million recorded in the same period in 1998, while communications services revenue grew 73 percent. On a sequential basis, Qwest reported a 14 percent increase from $1.02 billion in the third quarter of 1999 to $1.16 billion as a result of continued growth in Internet, multimedia and data services. Full year reported revenue increased 75 percent form $2.24 billion to $3.93 billion. Full year 1999 pro forma revenue increased 29 percent from $3.03 billion to $3.90 billion.
>
> Communications services EBITDA grew 19 percent compared to the third quarter of 1999. Pro forma 1999 EBITDA grew 92 percent to $760.2 million from $396.0 million in 1998, despite a 47 percent decline in construction EBITDA resulting from the mid-year completion of 18,500 miles of the U.S. portion of the company's North American network. Full year 1999 reported EBITDA increased 158 percent from $294.5 million to $759.2 million. Full year 1999 pro forma communications services EBITDA grew 238 percent over 1998.
>
> . . . .
>
> "We are extremely pleased to continue our strong financial performance in our core businesses, while our management team focuses on growing revenues globally through strategic initiatives, including the merger with U S WEST," said Joseph P. Nacchio, Qwest chairman and CEO. "In 1999 we made the necessary investments and commitments to continue to deliver to customers leading-edge broadband Internet communications solutions that will solidly position us as the new Internet communications company of the next decade."

> Robert S. Woodruff, Qwest executive vice president and chief financial officer, said, "The financial results for the year reflect Qwest's strong revenue growth and continued margin improvement as a result of our ability to manage expenses. We expect to continue to see strong revenue and EBITDA growth in 2000 led by the demand for Qwest's Internet-based applications and services. In 2000, we anticipate revenue will continue to grow in the range of 30-35 percent, with EBITDA growth of approximately 40-50 percent."

70. As set forth more fully above, the press release quoted Defendant Woodruff as representing that "strong revenue and EBITDA growth" would continue through 2000, "led by the demand for Qwest's Internet-based applications and services."

71. On February 17, 2000 Defendant Merrill reported, in its Highlights from NYC Analyst Meeting, "Qwest remains as one of our top fixed income recommendations in the telecom sector. We think that the Q's numbers have warranted triple-B status for some time."

3. Qwest's Reported Results For 2000

72. On April 19, 2000, Qwest issued a press release announcing its results for the first quarter of 2000, ended March 31, 2000. Comparing the results to those from the previous year, the release stated:

> - Internet and data revenues continued strong growth of more than 200 percent and comprise more than 30 percent of total revenue
> - Services revenue increased 65 percent
> - Total revenue grew 39 percent to $1.22 billion
> - Total EBITDA increased 52% to $236.0 million
> - Services EBITDA margins improved from 13.7 percent to 19.4 percent

73. The release predicted continued future growth, and quoted Defendant Woodruff as stating, "We are extremely pleased with the strong financial results

for the quarter, and expect continued strong revenue and EBITDA growth led by the demand for Qwest's Internet-based broadband applications and services."

74. The foregoing press release was incorporated in an 8-K filed by Qwest with the SEC on April 19, 2000. The 8-K also stated that Qwest "remain[ed] comfortable with the consensus of analysts' estimates for 2000 revenues of approximately $5.1 billion and EBITDA (earnings before interest, taxes, depreciation and amortization) of approximately $1.1 billion."

75. On May 9, 2000, Defendant Merrill's Credit Research Report highlighting the NYC Analyst Meeting stated that the new post-merger entity (US West and Qwest) "may benefit from global industry consolidation. Accordingly, we view USW as a core holding in the investment grade telecom sector."

76. On July 7, 2000, Qwest filed a registration statement and prospectus for 54,167,544 shares of common stock. The registration statement incorporated other filings, including Qwest's 10-K for the year ended December 31, 1999, filed March 17, 2000; its 8-Ks filed February 2, 2000, February 17, 2000 and April 19, 2000; and its 10-Q for the quarter ended March 31, 2000, filed May 12, 2000. The registration statement was signed by directors, including Defendants Nacchio and Woodruff.

77. On July 13, 2000, analyst Jack Grubman of Defendant Salomon stated, "With the closing of the USW merger, we are more confident than ever that Qwest is well positioned to drive value and we are raising our price target on Q from $65 to $80. . . We believe that the new company will successfully drive shareholder value by driving synergies and effectively deploying the combined company resources into significant capital spending towards growth initiatives."

78. On July 19, 2000, Qwest issued a press release announcing its results for the second quarter of 2000, ended June 30, 2000. Comparing the results to those from the second quarter of 1999, the release stated:

- Internet and data services posted growth of more than 150 percent for the quarter and now comprise more than 33 percent of total revenue
- Total revenue increased 47 percent to $1.28 billion
- Services EBITDA increased 91 percent to $256.0 million
- Services EBITDA margin increased to 20 percent from 17 percent
- Sequential revenue and EBITDA increased 5.4 percent and 8.5 percent, respectively

79. On August 24, 2000, Qwest issued a press release announcing its results for the third quarter of 2000, ended September 30, 2000, representing that the U S West merger had been a success and emphasizing that revenue growth for 2000 would "meet or exceed" expectations.

80. On November 11, 2000, Qwest filed with the SEC its 10-Q for the third quarter of 2000. The 10-Q reported commercial services revenues of $2.4 billion, representing a 104-percent increase over the same quarter a year before.

81. On March 16, 2001, Qwest filed with the SEC its 10-K for the year ended December 31, 2000. The 10-K claimed that revenues from IRU transactions were recognized in accordance with GAAP:

> Occasionally, the Company sells capacity on its network to other telecommunication providers. Sales of capacity are accounted for as either sales-type leases, operating leases or service agreements depending upon the terms of the transaction. Revenues related to sales of capacity that meet the criteria of a sales-type lease are recognized at the time of delivery of the capacity to the customer. If title is not transferred or if the other requirements for sales-type lease accounting are not met, revenue is recognized ratably over the term of the agreement.

82. The 10-K also claimed that revenues from Qwest's IRU transactions "were not significant in either fiscal 2000 or 1999":

> To a lesser extent, the Company sells capacity under indefeasible rights of use contracts. Revenues from

> these contracts are included in commercial services and were not significant in either fiscal 2000 or 1999.

83. In October 2000, Qwest's stock reached $50 a share, and the Company reported that it expected continued financial growth through 2001.

84. On December 20, 2000, after other carriers, including SBC Communications Inc. and AT&T Corp., reported that sales and profits would not meet forecasts owing in part to delays in obtaining regulatory approval to sell service and to costs of necessary network improvements, Qwest's stock closed down 14 percent on worries that it would share the same fate. Qwest was quick to deny the possibility, in a December 21, 2000 press release:

> Qwest Communications Reconfirms Financial Estimates For 2000 And 2001
>
> Company Says It Will Meet Or Exceed Analysts' Estimates for Revenue, EBITDA and EPS In Fourth Quarter, 2000
>
> Denver, December 21, 2000 – Qwest Communications International Inc. (NYSE: Q), the broadband Internet communications company, today reconfirmed its revenue and EBITDA (earnings before revenue, interest, taxes, depreciation and amortization) financial estimates for 2000 and 2001.
>
> Qwest Chairman and CEO Joseph P. Nacchio said Qwest is having a strong fourth quarter this year and it expects to meet or beat analysts' estimates for revenue, EBITDA and earnings per share for the quarter.
>
> "Qwest believes it is not having the same problems announced by several competitors because Qwest has newer assets, a lower cost position and a product line targeted to capitalize on the high-growth sectors of the industry," Nacchio declared. Qwest also provides local and advanced communications services in 14 Western states, which include half of the fastest-growing business markets in the United States.
>
> Nacchio said he is making a strong, specific statement today about Qwest's prospects because of recent market turmoil and extraordinary speculation about the likely results of major companies in the sector. Nacchio noted several companies have reduced guidance for 2000 and 2001.

> "Demand for our products and services remains robust and we continue to see our market share and revenues grow in key segments of the market, such as DSL, wireless, Web hosting and broadband Internet services. We are reconfirming the targets we set on Sept. 7, 2000 for this year and 2001 based on the continued strength of our business and our success in executing our strategic merger plan," Nacchio said. Qwest expects to end 2000 with the best customer service record in its local service area in the last seven years. Qwest also expects improved service will accelerate regulatory approval for re-entering the long distance market in the region.
>
> Qwest announced the following financial targets on Sept. 7, 2000:
>
> - For 2000, Qwest is targeting revenue in the range of $18.8 to $19.1 billion.
> - For 2001, Qwest is targeting revenue in the range of $21.3 to $21.7 billion.
> - EBITDA for 2000 is targeted at approximately $7.4 billion.
> - EBITDA for 2001 is targeted in the range of $8.5 to $8.7 billion.
>
> Qwest also reconfirmed its previously announced five-year (2000-2005) compounded annual growth targets of 15 to 17 percent for revenue and approximately 20 percent for EBITDA.

85. On December 21, 2000, Jack Grubman of Defendant Salomon reiterated a "Buy" rating on Qwest and a price target of $80.

86. On January 16, 2001, Qwest issued a press release announcing that it was purchasing 22 million shares of Qwest stock at $45 per share from BellSouth Corporation, in a reciprocal transaction involving BellSouth's agreement to purchase $250 million in services over five years. The press release stated that Qwest was purchasing the stock because it believed the stock was a good buy at $45 a share.

87. On January 24, 2001, Qwest issued a press release announcing its results for the fourth quarter of 2000 and year ended December 31, 2000, claiming year-end revenues of $18.95 billion and EBITDA of $7.37 billion, and expressing

continued confidence that Qwest was on target to meet predicted growth rates. The release stated:

> Qwest Communications Reports Strong Fourth Quarter and Full-Year 2000 Results Driven By Growth In Internet, Data and Wireless Revenues
>
> Quarterly Revenue Exceeds $5 billion; Full-Year 2000 Pro Forma Revenue Grew More Than 14 percent to $19 billion; Revenue, EBITDA, and EPS Exceed Consensus Estimates
>
> . . . .
>
> Denver, January 24, 2001 – Qwest Communications International Inc. (NYSE: Q), the broadband Internet communications company, today announced record revenue and earnings before interest, taxes, depreciation and amortization (EBITDA) for the fourth quarter and full-year 2000. Qwest has met or exceeded the consensus of analysts' estimates for the 15th consecutive quarter.
>
> "Results for the quarter demonstrate Qwest's strong position in the industry and our ability to execute the business plan," said Joseph P. Nacchio, Qwest chairman and CEO. "With the initial integration of the merger successfully completed, we are on track to meet our expected growth rates."
>
> Fourth quarter revenue of $5.02 billion was a 9.9 percent increase over pro forma normalized fourth quarter 1999. The revenue growth was driven by strong demand for Internet and data services, which increased by almost 40 percent in the quarter. Wireless services revenue grew 90 percent in the quarter to almost $150 million with more than 805,000 customers at year-end. Commercial services revenue increased more than 19 percent, while consumer and small business services generated revenue growth of more than five percent. Total 2000 pro forma normalized revenue increased 14.2 percent to $18.95 billion from pro forma normalized 1999 revenue of $16.59 billion. Internet and data services, a high-growth segment for Qwest, grew more than 60 percent in 2000.
>
> Fourth quarter EBITDA grew 19.7 percent to $1.99 billion as EBITDA margins improved 330 basis points to 39.6 percent in the fourth quarter of 2000 from 36.3 percent in fourth quarter of 1999. The increase in EBITDA margins resulted from an improved product mix, cost controls, network efficiencies and merger synergies. Pro forma normalized 2000 EBITDA increased more than 17.3 percent to $7.37 billion as

EBITDA margins improved to 38.9 percent in 2000 from 37.9 percent in 1999. The EBITDA improvement was achieved despite significant investments in growth areas such as hosting, local broadband access, Internet and data services, and service improvements.

"We are extremely pleased with our strong operating and financial results for the fourth quarter and full-year 2000," said Robert S. Woodruff, Qwest executive vice president and CFO. "We achieved significant revenue and EBITDA growth while integrating a large acquisition and investing for growth. We remain confident that we will achieve our financial commitments for 2001 of $21.3 to $21.7 billion in revenue and $8.5 to $8.7 billion in EBITDA."

88. On January 24, 2001, Qwest filed an 8-K with the SEC incorporating the foregoing press release and reporting further that, in a conference call, the Company had expressed its expectation that "revenue would grow between 11.5% and 12.5% for the 1st quarter of 2001 over the 1st quarter of 2000. It expected higher growth rates in the subsequent quarters."

4. Qwest's Reported Results For 2001

89. On February 16, 2001, Qwest issued a press release assuring the public that its acquisitions had been successful and that it was meeting its goals:

Qwest Communications Is Succeeding, Says CEO Nacchio, While Shareowners, Customers Demand More

Denver, February 16, 2001 – Qwest Communications International Inc. (NYSE: Q) is continuing to succeed in a marketplace that is undergoing significant structural change while shareowners and customers are placing dramatically different demands on chief executive officers, Qwest Chairman and CEO Joseph P. Nacchio told an audience at the University of Pennsylvania's Wharton School.

Nacchio said the telecommunications industry is undergoing structural change as older companies reposition themselves for the future. Speaking Thursday evening at a Wharton media and technology conference, Nacchio said Qwest had grown quickly in less than four years through seven mergers or acquisitions. He said that had been a smart way for Qwest to grow as it was maturing as a company.

On Jan. 24, Qwest announced fourth quarter 2000 results saying it had met or exceeded the consensus of analyst's

> estimates for the 15th consecutive quarter since becoming a public company in 1997. The company also reconfirmed on Jan. 24 its 2001 targets for revenue and earnings before interest, taxes, depreciation and amortization (EBITDA).

90. On February 26, 2001, Qwest filed an 8-K incorporating a press release regarding two speeches by Defendant Nacchio. The release stated:

> Following his prepared remarks, Mr. Nacchio responded to questions from the audience. In response to these questions, Mr. Nacchio stated the following, among other things:
>
> Based on his review of Qwest results for January 2001, he was comfortable with previously announced guidance for 2001 for revenues of $21.3 billion to $21.7 billion (a 12.5% to 14.5% increase over pro forma revenues for 2000) and EBITDA (earnings before interest, taxes, depreciation and amortization) of $8.5 billion to $8.7 billion (a 14.9% to 17.6% increase over pro forma EBITDA for 2000).
>
> He expected that total revenues would grow between 11.5% and 12.5% for the 1st quarter of 2001 over pro forma revenues for the 1st quarter of 2000. He expected higher growth rates in subsequent quarters.

91. On March 15, 2001, Qwest filed an 8-K reporting that Defendant Mohebbi had appeared at a conference hosted by Defendant Merrill Lynch. The 8-K stated:

> At the conference, Mr. Mohebbi stated the following, among other things:
>
> > Based on his review of Qwest results for January and February 2001, he was comfortable with previously announced guidance for 2001 for revenues of $21.3 billion to $21.7 billion (a 12.5% to 14.5% increase over pro forma revenues for 2000) and EBITDA (earnings before interest, taxes, depreciation and amortization) of $8.5 billion to $8.7 billion (a 14.9% to 17.6% increase over pro forma EBITDA for 2000).
> >
> > Based on those results, he was comfortable with previously announced guidance that total revenues would grow between 11.5% and 12.5% for the 1st quarter of 2001 over

> pro forma revenues for the 1st quarter of 2000.

92. On March 16, 2001, even as stock prices were declining, Jack Grubman of Defendant Salomon recommended Qwest, claiming, "Over the next 12 to 18 months, investors will look back at current prices of the leading players and wish that they had bought stock at these prices."

93. On March 22, 2001, Qwest filed an 8-K that, in response to a decline in stock price to the mid-$30 levels, assured investors that the Company's performance was on track and would remain strong in spite of the current problems experienced by other telecommunications companies:

> On March 22, 2001, Joseph P. Nacchio, Chairman and Chief Executive Officer of Qwest Communications International Inc. ("Qwest"), is speaking with a group of investors. At the meeting, Mr. Nacchio is stating the following, among other things:
>
> > Based on the results for January and February, which showed strong growth in Qwest's Business Markets, Wholesale Markets, DSL and certain other businesses, he is comfortable with previously announced guidance of (1) revenue growth of between 11.5% and 12.5% for the 1st quarter of 2001 over pro forma revenues for the 1st quarter of 2000, (2) revenues of $21.3 billion to $21.7 billion (a 12.5% to 14.5% increase over pro forma revenues for 2000) and EBITDA (earnings before interest, taxes, depreciation and amortization) of $8.5 billion to $8.7 billion (a 14.9% to 17.6% increase over pro forma EBITDA for 2000), in each case for 2001, and (3) compounded annual growth rates for revenue of 15% to 17% and EBITDA of 20% over the period 2000 to 2005.

94. On March 29, 2001, Qwest filed an 8-K stating:

> On March 29, 2001, Afshin Mohebbi, President – Worldwide Operation of Qwest Communications International Inc. ("Qwest"), is speaking at a conference hosted by an investment banking firm. At the conference, Mr. Mohebbi is stating the following, among other things:

> Based on his review of Qwest's results for January and February 2001, he is comfortable with previously announced guidance of (1) revenue growth of between 11.5% and 12.5% for the 1st quarter of 2001 over pro forma revenues for the 1st quarter of 2000, (2) 2001 revenues of $21.3 billion to $21.7 billion (a 12.5% to 14.5% increase over pro forma revenues for 2000) and 2001 EBITDA (earnings before interest, taxes, depreciation and amortization) of $8.5 billion to $8.7 billion (a 14.9% to 17.6% increase over pro forma EBITDA for 2000), and (3) compounded annual growth rates for revenue of 15% to 17% and EBITDA of 20% over the period 2000 to 2005.

95. On April 24, 2001, Qwest issued a press release announcing its results for the first quarter of 2001, ended March 30, 2001, and claiming that revenues and profits were on track with projections. The release stated:

> DENVER, APRIL 24, 2001 – Qwest Communications International Inc. (NYSE: Q), the broadband Internet communications company, today announced record revenue and earnings before interest, taxes, depreciation and amortization (EBITDA) for the first quarter of 2001. Total first quarter revenue of $5.05 billion was an 11.8 percent increase versus pro forma normalized first quarter 2000 revenue. First quarter EBITDA grew 15.8 percent to $2 billion. In addition, Qwest recorded pro forma normalized earnings per diluted share of $0.13 for the quarter. Qwest has met or exceeded the consensus of analysts' estimates for the sixteenth consecutive quarter.
>
> "We are extremely pleased with the results the Qwest team achieved during the quarter. With our unique blend of assets, Qwest is well positioned for future growth across all segments of the communications marketplace," said Joseph P. Nacchio, Qwest's chairman and CEO. "We believe the industry will continue to provide solid growth opportunities in 2001, especially for our broadband Internet and data services. Qwest is well positioned to take advantage of that growth at the local, national and global level."
>
> The total revenue increase was driven by Internet and data services growth of 44 percent as demand for Qwest services remains robust. Digital subscriber line (DSL) growth remained strong with an increase of more than 125 percent annually to more than 306,000 customers. Commercial services revenues increased 26.5 percent to

> $2.7 billion as Qwest continued to focus on the broadband Internet and data needs of enterprise and wholesale customers. The company's small business and consumer units recorded services revenue growth of 6.3 percent, or 2.7 percent including out-of-region long-distance results.
>
> First quarter EBITDA grew 15.8 percent to $2 billion as EBITDA margins expanded 130 basis points from 38.2 percent in first quarter 2000 to 39.5 percent in first quarter 2001. This increase in EBITDA margin resulted from continued tight cost controls and productivity improvements, as well as merger-related synergies.

96. On April 25, 2001, Qwest filed with the SEC an 8-K incorporating the foregoing press release.

97. On May 15, 2001, Qwest filed with the SEC its 10-Q for the first quarter of 2001. The 10-Q reported the results claimed in Qwest's April 24, 2001 press release, including commercial services revenues of $2.75 billion. The 10-Q further stated that "[t]he increase in commercial services revenues for the three months ended March 31, 2001 was primarily attributable to growth in our data and Internet services."

98. On June 18, 2001, Jack Grubman of Defendant Salomon recommended Qwest, saying that its long distance network service would push up revenue and that the revenue boost should push the stock from $36 to $50 inside a year.

99. On August 14, 2001, Qwest filed its 10-Q for the second quarter ended June 30, 2001, claiming that revenues were increasing and stating that Qwest had recognized sales on IRU agreements:

> Commercial Services Revenues. Commercial services revenues are derived from sales of IP, data, voice and wireless products and services provided to both retail and wholesale business customers. The increase over the prior periods in commercial services revenues for the three and six months ended June 30, 2001 were 26.7% and 26.6%, respectively, primarily attributable to growth in our IP and data services (DIA, virtual private network, Internet dial access, optical private lines, ATM and frame relay). During the three and six month periods ended June 30, 2001, we recognized $430 million and

> $857 million, respectively, in optical capacity sales under indefeasible right of use ("IRU") agreements versus $197 million and $416 million, respectively, for the comparable periods in 2000.

100. The 10-Q further stated, "Certain rule-making bodies, such as the Emerging Issues Task force, are currently discussing matters which may impact the accounting for sale-type leases. We actively monitor these rule-making activities and evaluate their impact on our current accounting practices."

101. On July 12, 2001, Qwest filed a registration statement on Form S-4 for $3.25 billion in notes, stating Qwest's reported earning and revenue figures for 1999, 2000 and 2001 to date, as set forth herein; and incorporating Qwest's 10-K for the year ended December 31, 2000; its 10-Q for the quarter ended March 31, 2001; its 8-Ks filed January 25, 2001, February 27, 2001, March 15, 2001, March 22, 2001, March 29, 2001, April 5, 2001, April 25, 2001, April 27, 2001, May 17, 2001, June 5, 2001 (as amended by a report on Form 8-K/A filed June 5, 2001), June 8, 2001, June 20, 2001 and June 21, 2001; and the false statements and omissions as to Qwest's revenues and other financial prospects contained in those documents. The registration statement was signed by Individual Defendants Szeliga, Anschutz, Nacchio, Barrett, and Khosla, and was filed with the signed consent of Defendant Andersen.

102. In July 2001, Defendant Nacchio affirmed earnings guidance, and Wall Street continued to tout the stock.

103. On August 3, 2001, Jack Grubman of Defendant Salomon reiterated a "Buy" rating for Qwest and represented, "Bottom line is that we feel that Q [Qwest] is undervalued."

104. On August 17, 2001, Defendant Merrill reported that "Qwest Communications International is the best of both worlds, the prototype US phone company."

105. On September 10, 2001, Qwest issued a press release and held a conference call, revising downward its guidance for revenues and earnings in 2001 and 2002. Qwest claimed that general economic conditions were responsible for the downturn:

> Denver, September 10, 2001 – Qwest Communications International Inc. (NYSE: Q), the broadband communications company, today updated its financial guidance for the second half of 2001 and for 2002. The new guidance reflects deteriorating economic conditions both nationally and within the 14 Western states in which Qwest provides local communications services.
>
> For 2001, Qwest expects total revenue of approximately $20.5 billion and earnings before interest, taxes, depreciation and amortization (EBITDA) of approximately $8.0 billion. For 2002, Qwest expects revenue growth in the high single digits and EBITDA growth to be slightly better than revenue growth.
>
> Qwest also announced further reductions in its capital expenditures for 2001 from approximately $8.8 billion to approximately $8.5 billion. In 2002, Qwest's capital budget will be reduced from approximately $7.5 billion to approximately $5.5 billion. As a result, Qwest expects to be free cash flow positive in the second quarter of 2002, two quarters sooner than previously announced.
>
> Qwest expects to reduce its workforce by 4,000 jobs, from 66,000 to 62,000 employees, by the end of the first quarter of 2002. The company also will eliminate 1,000 staff positions while adding 1,000 quota-bearing sales executives in its global business markets unit to increase the focus on national accounts. Qwest expects to achieve this force reduction through attrition and continued business process improvements.

106. On October 30, 2001, Qwest filed a registration statement on Form S-4 for $3.75 billion in notes, incorporating other filings with the SEC, including Qwest's 10-K for the year ended December 31, 2000 (as amended by a report on Form 10-K/A filed August 20, 2001); its 10-Qs for the quarters ended March 31, 2001 and June 30, 2001; and its 8-Ks filed January 25, 2001, February 27, 2001, March 15, 2001, March 22, 2001, March 29, 2001, April 5, 2001, April 25, 2001, April 27, 2001, May 17, 2001, June 5, 2001 (as amended by a report on Form 8-K/A filed June 5, 2001), June 8, 2001, June 20, 2001, June 21, 2001, July

20, 2001, July 26, 2001 (as amended by a report on Form 8-K/A filed July 26, 2001), August 7, 2001 (as amended by a report on Form 8-K/A filed August 13, 2001) and September 10, 2001. The registration statement was signed by Individual Defendants, including Defendants Nacchio, Szeliga, Anschutz, Barrett, and Khosla; and was filed with the signed consent of Defendant Andersen.

107. On October 31, 2001, Qwest issued a press release announcing its results for the third quarter of 2001, ended September 30, 2001. Reporting a loss of $0.09 per share for the quarter, and explaining that the recession caused the disappointing results, the release stated:

> DENVER, October 31, 2001 – Qwest Communications International Inc. (NYSE: Q), the broadband communications company, today announced its financial results including revenue and earnings before interest, taxes, depreciation and amortization (EBITDA) for the third quarter of 2001. Third quarter reported revenue of $4.77 billion equaled third quarter revenue a year ago while pro forma normalized EBITDA decreased 5.3 percent from $1.86 billion in the third quarter a year ago to $1.77 billion in the third quarter 2001. In addition, Qwest reported a net loss of ($142) million, or ($0.09) per share in the third quarter of 2001 compared to a reported net loss of ($248) million or ($0.15) per share in the third quarter a year ago. On a pro forma normalized basis, the company recorded an ($0.08) loss per share for the third quarter compared to earnings of $0.14 per diluted share a year ago. The decrease reflects the impact of lower EBITDA and the related cumulative adjustment to the annual effective tax rate as well as increases in both interest expense and depreciation driven by Qwest's capital plan.
>
> . . . .
>
> "Our results reflect the continuing impact of a slowing economy as well as a fundamental shift in the wholesale customer buying behavior for optical capacity asset sales," said Joseph P. Nacchio, Qwest chairman and CEO. "We are continuing to focus on retail revenue growth and the generation of free cash flow from operations. Our blend of assets, products, and expanding distribution channels positions us well for the economic recovery, and we continue to be the model to which the industry will eventually evolve."

108. In a press release issued December 13, 2001 and incorporated into an 8-K filed December 14, 2001, Qwest reduced predictions for 2001 and 2002, citing the bad economy:

> QWEST COMMUNICATIONS TO UPDATE FINANCIAL GUIDANCE FOR 2001 AND 2002 AT ANALYST CONFERENCE
>
> DENVER, December 13, 2001 – Qwest Communications International Inc. (NYSE: Q), the broadband communications company, will update its financial guidance for the fourth quarter and full year 2001 and for 2002 at its analyst meeting in Denver.
>
> The new guidance reflects continued economic softness both nationally and within the 14 Western states in which Qwest provides local communications services as well as a decrease in demand for wholesale broadband capacity services.
>
> For the fourth quarter of 2001, Qwest expects reported revenue of approximately $4.8 billion and earnings before interest, taxes, depreciation and amortization (EBITDA) of approximately $1.7 billion. For the full year 2001, the company expects reported revenue of approximately $19.8 billion and EBITDA of approximately $7.45 billion.
>
> For 2002, Qwest expects reported revenue in the range of $19.4 to $19.8 billion and EBITDA in the range of $7.1 to $7.3 billion. This represents a reduction of zero to two percent from 2001 expected revenue, and two to five percent from 2001 expected EBITDA in each case on a reported basis. On a recurring revenue basis, the 2002 estimate represents a five to seven percent growth over recurring revenues for 2001.
>
> Qwest also announced reductions in its capital expenditures for 2002 from previous guidance of approximately $5.5 billion to a range of $4.2 to $4.3 billion. Qwest's resulting 2002 capital to revenue ratio is in the same range as other large communications companies. Qwest expects to be free cash flow positive in the second quarter of 2002 and beyond.
>
> For 2001, the company expects a reported net loss per share in the range of ($2.30) to ($2.38) and normalized earnings per share of $0.07 to $0.08. Qwest expects normalized cash earnings per share for 2001 in the range of $0.78 to $0.79. For 2002, Qwest expects reported earnings per share in the range of $0.17 to $0.24 and cash earnings per share in the range of $0.29 to $0.36, in

each case giving effect to the new FAS 142 accounting rules that go into effect on January 1, 2002.

109. On December 13, 2001, in a press release incorporated into a Form 8-K filed December 14, 2001, Qwest denied rumors that it had improperly recognized revenues from transactions with KMC Telecom Holdings, described below:

> QWEST COMMUNICATIONS STATEMENT REGARDING KMC TELECOM HOLDINGS
>
> Denver, February 13, 2002 – Qwest Communications International Inc. today issued the following statement in response to a Wall Street Journal article regarding Qwest's relationship with KMC Telecom Holdings Inc.:
>
> Qwest entered into its relationship with KMC to accelerate Qwest's entry in the fast-growing dial-up Internet market. The relationship enabled Qwest to rapidly deploy an Internet platform to support major contracts with leading access and content providers such as AOL Time Warner and Microsoft's MSN unit. The company has previously disclosed its relationship with KMC to investors and has accounted for the transactions using standard accounting practices.

110. On December 14, 2001, Defendant Lehman gave Qwest a "Strong Buy" rating.

111. On January 29, 2002, Qwest issued a press release announcing its results for the fourth quarter of 2001 and year ended December 31, 2001. The release stated:

> DENVER, January 29, 2002 – Qwest Communications International Inc. (NYSE: Q) today announced its financial results for the fourth quarter and the full year of 2001. For the quarter, the company recorded a ($0.07) pro forma normalized loss per diluted share compared with pro forma normalized earnings per diluted share of $0.16 for the same period last year. For the year, it recorded pro forma normalized earnings per diluted share of $0.05 compared with pro forma normalized earnings per diluted share of $0.59 for 2000.
>
> . . . .
>
> Reported revenue for the quarter was down approximately six percent to $4.70 billion, down $314 million from $5.02 billion in the same period last

year. The decrease in revenues for the quarter was mainly due to reduced optical capacity asset sales and certain Internet equipment sales. For the full year, reported revenue increased approximately four percent to $19.74 billion compared with pro forma normalized 2000 revenues of $18.95 billion, or approximately 19 percent compared to 2000 reported revenues of $16.61 billion.

Recurring revenue for the quarter of $4.68 billion declined slightly as compared to $4.70 billion in the fourth quarter of 2000. Recurring revenue for Internet services grew 30 percent, or $67 million in the fourth quarter of 2001, compared with the same period last year. Wireless revenues grew 42 percent, or $62 million in the fourth quarter of 2001, compared with the same period last year. These strong growth rates were offset by weakness in local and traditional data services, reflecting continued slowing of the regional economy. Internet and data services recurring revenue of $1.03 billion for the quarter grew three percent over the same period last year and now represents approximately 22 percent of recurring revenue for the company. For the full year, recurring revenue increased five percent to $18.44 billion compared with recurring pro forma normalized 2000 revenues.

For the quarter, pro forma normalized earnings before interest, taxes, depreciation and amortization (EBITDA) was $1.61 billion compared with pro forma normalized EBITDA for the same period last year of $1.99 billion. This decline was mainly due to reduced optical capacity asset sales and certain Internet equipment sales. In addition, EBITDA was also impacted by continued investments in new product platforms and 271 re-entry, changes in product mix and an increase in uncollectible accounts due to continued weakness in the economy. For the year, Qwest recognized pro forma normalized EBITDA of $7.40 billion compared with pro forma normalized EBITDA of $7.37 billion in 2000.

112. On January 30, 2002, Qwest filed with the SEC an 8-K incorporating the full-year 2001 results it had announced, and further stating:

It expected its results in 2002 would be at or near the low end of prior guidance. That guidance was for reported revenue in the range of $19.4 to $19.8 billion and earnings before interest, taxes, depreciation and amortization ("EBITDA") in the range of $7.1 to $7.3 billion. Owing to the changed economic conditions and seasonality of its business, among other things, it expected its results for the first quarter of 2002 would be lighter than those for the rest of 2002, and could be as

> weak as or weaker than those for the fourth quarter of 2001.

5. Qwest's Reported Results For 2002

113. On March 11, 2002, in a press release incorporated into a Form 8-K filed that same day, Qwest acknowledged that the SEC was investigating its revenue recognition practices, including its sales of IRUs, its KMC and Calpoint contracts, and its Qwest Dex directory services revenues:

> DENVER, MARCH 11, 2002 – Qwest Communications International Inc. today said it received an informal inquiry from the Denver regional office of the Securities and Exchange Commission (SEC) requesting voluntary production of documents. Qwest intends to respond fully to this request, which was received in a letter Friday, March 8, 2002.
>
> The matters identified by the SEC as the focus of the informal inquiry have previously been the subject of disclosure by Qwest and have been widely reported in the investment community and in the media. The matters relate to three areas of Qwest's accounting policies, practices and procedures in 2000 and 2001, including revenue recognition and accounting treatment of (i) sales of optical capacity assets (often referred to as Indefeasible Rights of Use or "IRUs"), particularly sales to customers from whom the company agreed to purchase optical capacity; (ii) the sale of equipment by Qwest to customers from which Qwest bought Internet services or to which Qwest contributed equity financing, including equipment sales to KMC and Calpoint; and (iii) Qwest Dex, particularly changes in the production schedules and lives of some directories. The SEC informed Qwest that this informal inquiry is not an indication that it or its staff believes any violation of law has occurred, nor should Qwest consider the inquiry an adverse reflection on any entity or security
>
> Qwest has stated, and continues to believe, that its accounting policies, practices and procedures for all periods, including 2000 and 2001, comply with all applicable requirements. There can be no assurance that the SEC will agree.
>
> Qwest believes the issues that may be raised by the inquiry in connection with the three types of transactions described above do not relate to a material amount of revenues or earnings before interest, taxes, depreciation and amortization ("EBITDA"), on either an as reported or pro forma normalized basis, during either period. However, due in part to the relatively small amounts of

net income (loss) and earnings (loss) per share during these periods, they may relate to a material amount of net income (loss) or earnings (loss) per share, on an as reported or pro forma normalized basis, during those periods.

V. THE NOTE OFFERINGS

114. Based upon Defendants' representations of Qwest as a successful and growing company, Qwest was able to raise funds through the following note offerings, including the exchange of notes.

Qwest Offerings		
Date	**Nature of Offering**	**Total Dollar Amount**
01/17/01	7.9% notes due 2010	$1.75 billion
07/12/01	7.25% notes due 2011	$2.25 billion
07/12/01	7.75% notes due 2031	$1 billion
10/30/01	7% notes due 2009	$2 billion

VI. THE FALSITY OF THE REPRESENTATIONS

115. The above financial statements, results, press releases, and filings with the SEC were false. By the time that Qwest announced the merger with US West in 1999, it knew that it was experiencing many of the same problems encountered by other telecommunications companies, due in part, to the construction of excess capacity with respect to market needs and changing market conditions. Qwest and the Individual Defendants knew that if the true facts became known that Qwest's stock price would decline and that the merger, and Qwest's future, would be threatened. Qwest and the Individual Defendants knew if Qwest's stock price dropped, it would have to pay cash to U S West shareholders or the merger could be cancelled. To hide Qwest's true financial condition, Qwest, the Individual Defendants and Andersen entered into a scheme to keep Qwest's stock price artificially high by artificially inflating revenues. The scheme, as entered into among Qwest, the Individual Defendants, and Andersen, and with the knowledge, consent and active participation of the Bank Defendants,

was to improperly book revenue from IRUs; engage in improper swap transactions with other companies that lacked economic substance; and improperly book expenses.

116. The SEC, FASB and others are concerned that a company's financial statements accurately reflect the company's financial position. According to GAAP standards:

(a) Financial reporting should provide information about an enterprise's financial performance during a time period. (FASB Statement of Concepts No. 1, ¶ 42). This information is often used by investors and creditors in order to evaluate whether they are interested in future investment and credit offerings;

(b) Financial reporting should be reliable and relevant in that it represents what it purports to represent (FASB Statement of Concepts No. 2, ¶¶ 58-59);

(c) Financial reporting should be complete, in other words, all information that may be necessary to assure that it validly represents underlying events and conditions must be provided (FASB Statement of Concepts No. 2, ¶ 79);

(d) Financial reports should be conservative. Preparers must adequately consider uncertainties and risks inherent in business situations and reflect those issues in the reports (FASB Statement of Concepts No. 2, ¶¶ 95, 97).

117. In order to recognize revenue, GAAP's overriding principle is that revenue generally should not be recognized until "realized" or "realizable" and "earned." FASB Statement of Concepts, No. 5, ¶ 83.

A. Improperly Booked Revenues From Indefeasible-Rights-Of-Use Transactions With Other Telecommunications Companies

118. During 1999, 2000 and 2001, Qwest inflated its reported revenues by fraudulently recognizing sales IRUs of its optical capacity to other companies.

119. On March 21, 2002, John M. Morrissey, Deputy Chief Accountant for the SEC testified before the House Subcommittee on Oversight and Investigations Committee on Financial Service. He provided analysis of the proper accounting treatment for IRUs. As he testified:

> For the provider of the capacity, the fundamental accounting issue related to an IRU is when to recognize

> revenue. That determination can be quite complex, but can be boiled down to two basic questions: Is the IRU a lease or is it a service contract? And if it is a lease, what kind of lease is it – a sales-type lease, for which revenue is recognized up-front, or any operating lease, for which revenue is recognized over time.

120. Morrissey then explained that under GAAP, "revenues associated with long-term service contracts are generally recognized over time as performance occurs." FASB Interpretation No. 43 and FASB 66 provide the conceptual framework for the accounting treatment. The SEC published, on December 3, 1999, Staff Accounting Bulletin No.104, 17 CAR Part 211,which also discusses the accounting treatment for service contracts.

121. For a lease, FASB Statement of Accounting Standards No. 13, Accounting for Leases applies. Morrissey explained:

> To the extent that a network capacity contract conveys to the purchaser the right to use specified identifiable assets for a period of time, providers of this capacity have concluded that such a contract meets the definition of a lease. If the network capacity does not convey to the purchaser the right to use specific identifiable assets, the contract would be viewed as an arrangement for the provision of services, and revenues would be recognized over the period of the contracts as the services (the access to the network capacity) are provided. (Footnote omitted).

122. Even when the capacity contract meets the definition of a lease, one still must determine if there is a sales-type lease (where revenue is recognized in the same period the sale is recognized) or an operating lease (where revenues are recognized over the term of the lease). Morrissey explained:

> For a network capacity transaction to be appropriately classified and accounted for as a sales-type lease, certain specific criteria must be met. Otherwise the transaction must be classified and accounted for as an operating lease. Further complicating this issue, these criteria differ depending on whether the leased asset is considered equipment or real estate. Under SAS No. 13, and the related interpretations of this standard, a lease of real estate must transfer title in the lease assets to the lessee in order to be classified and accounted for as a sales-type lease by the lessor. Equipment leases need not

> transfer title in the leased assets to the lessor in order to be classified as sales-type leases.
>
> *Real estate or equipment*: The FASB issued Interpretation No. ("FIN") 43 in June 1999 which was effective for transactions entered into after June 30, 1999. FIN 43 provides interpretive guidance on the definition of real estate for accounting evaluations. This guidance, along with additional interpretive guidance provided by the FASB's Emerging Issues Task Force ("EITF"), has the general effect of rendering the assets subject to telecommunications capacity agreements as real estate for accounting purposes. When the interpretation in FIN 43 and the related EITF guidance became effective, many telecommunications capacity sellers concluded that they were unable to meet the title transfer requirement for the assets subject to the IRU and, therefore, were required to account for the subsequent capacity sale transactions as operation leases. Prior to FIN 43, the assets subject to telecommunications capacity agreements were generally viewed as equipment, and frequently, providers of capacity accounted for these agreements as sales-type leases.

123. Although, under these GAAP rules, the revenues for IRUs clearly had to be recognized over time, Qwest and the Individual Defendants instead, with the guidance of Andersen, recognized the revenue for the IRUs immediately, including contracts with Cable & Wireless, Global Crossing, and Enron Corp.

B. <u>Qwest's Reporting Of Reciprocal Transactions Violated GAAP</u>

124. Another scheme that Qwest used to inflate revenues was to engage in fraudulent reciprocal or swapping agreements with other companies. Both companies would agree to buy goods or services from the other at inflated prices, booking the revenue immediately and deferring expense related to the purchase, which allowed both companies' revenues to be inflated.

125. Morrissey in his testimony to Congress explained: "In general, GAAP requires that the accounting for the exchange of nonmonetary assets be based on the fair market value of the asset received or given up, whichever is more reliably determinable. One of the exceptions to this general principle is an asset exchange that does not represent the culmination of the earnings process."

> In order to conclude that a network capacity swap transaction should appropriately be accounted for as revenue and a capital expenditure at fair value, a company entering into such a transaction would have to reach the conclusion that: 1) the network capacity received in the exchange will not be sold in the same line of business as the network capacity given up in the exchange, 2) the network capacity received in the exchange is a productive asset that is dissimilar to the network capacity given up, and 3) the fair values of the assets exchanged are determinable within reasonable limits.

126. In November 1999 and January 2000, the Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board ("FASB") issued EITF 99-17 in response to these concerns. In essence, this accounting standard explicitly prohibits a company from reporting gross revenue from reciprocal transactions as having been earned unless specific conditions have been met. *See also* Staff Accounting Bulletin 101, 17 C.F.R. § 211.

127. GAAP requires that any company that is involved in material nonmonetary transactions must disclose, in the footnotes, the nature of the transaction, the basis for accounting for the assets transferred, and gains or losses recognized. Nonmonetary asset exchanges that do not result in cash receipts also must be disclosed in the footnotes.

128. Qwest and the Individual Defendants entered into a scheme, with the assistance and approval of the other Defendants, to artificially inflate revenue through reciprocal transactions that were not disclosed on Qwest's financial statements. Some of these capacity swaps involved "dark fiber," which was not even expected to be "lit" for the foreseeable future. "Dark fiber" refers to fiber optic network cables which have been laid but which have not yet entered active service, and which require installation of further networking equipment to become operational or "lit."

129. On July 30, 2002. the *New York Times* reported that:

> Qwest is thought to have been the most aggressive of a coterie of companies, including Enron and Global

> Crossing, that employed creative accounting strategies for swaps of communications capacity.
>
> These swaps, many of which were designed in conjunction with and blessed by their former auditor, Arthur Andersen, allowed these companies to convince investors that their business prospects were not deteriorating despite a rapid erosion of prices for their core product, fiber optic capacity. The technique they used was to trade network circuits of comparable value even when there was little justifiable need.

1. KMC Telecom Holdings

130. Qwest entered into and concealed reciprocal transactions with KMC Telecom Holdings Inc. ("KMC") to inflate revenues by recognizing $450 million in equipment sales.

131. In 2000 and 2001, in several similar transactions, Qwest "sold" $450 million in equipment to KMC and agreed to pay roughly the same amount to KMC for Internet services. Although Qwest used the transactions to boost its revenue figures, it failed to report the transactions in its filings with the SEC.

132. In March 2000, Qwest sold KMC $134 million of "portal equipment," and agreed to buy associated services from KMC through 2003. Even though the transaction represented more than 10 percent of Qwest's communications services revenues for the period, Qwest's 10-Q for the first quarter of 2000, filed in May 2000, did not disclose the transaction and misleadingly attributed the "growth" to legitimate business sales:

> During the three months ended March 31, 2000, as compared to the same period of the prior year, Communications Services revenue increased due to the growth in Internet, multimedia, data and voice services sold to business, government and wholesale customers.

133. In June 2000, Qwest entered into another contract in which KMC would purchase $168 million in "Internet infrastructure" equipment, and Qwest agreed to pay KMC for installing and using the equipment to provide service to Qwest through August 2004.

134. In March 2001, Qwest sold KMC $65 million of Internet phone routing equipment, and agreed to pay KMC $115 million over five years for using the equipment to handle service for Qwest.

135. In June 2001, Qwest sold KMC $83 million in Internet routers and switches, and agreed to pay $42.4 million per year through 2006 for using the equipment to provide service to Qwest.

136. Qwest's reported revenues from the transactions totaled some $300 million in 2000; and $148 million in the first and second quarters of 2001.

137. In fact, in its transactions with KMC, Qwest agreed to pay a greater amount in service fees over the next five years than it would receive from KMC for the equipment it supplied. Yet, Qwest recognized the sale of equipment to KMC immediately but did not at the same time disclose or recognize the reciprocal obligation to buy services for a greater amount over the next five years.

138. Lacking a legitimate business purpose, the reciprocal transactions served their purpose of allowing Qwest to book hundreds of millions of dollars in illusory revenues, giving the impression the Company was profitable and its business was growing rapidly.

2. Calpoint

139. In October 2001, Qwest entered into a contract with Calpoint LLC ("Calpoint") by which it inflated its revenues.

140. In the transaction, Qwest recognized revenues of $300 million from the sale of optical-networking equipment to Calpoint. However, in the deal, Qwest agreed to pay Calpoint $125 million per year over the next five years, for a total of over $600 million, to lease back capacity Calpoint would provide using the purchased equipment.

141. Through the deal, Qwest's present revenues were inflated at the cost of future expenditures exceeding the revenue gain, in a transaction without any legitimate business purpose.

3. *Enron*

142. On September 30, 2001, the last day of the third quarter of 2001, Qwest entered into a $500 million reciprocal IRU transaction with Enron, on which it recognized $195.5 million in revenues for that quarter. There was no business justification for the deal. However, it boosted revenues for the firms. Significantly, Qwest did not announce the Enron deal after it was made.

143. A March 29, 2002 article in the *New York Times* cited an Enron executive who stated, "We (Enron) will overpay for the assets, and you (Qwest) will overpay me on the contract. They had a pinch in the third quarter and needed a deal."

144. The same article cited "people close to the September deal" who stated that there was a larger deal in the works between the two companies, which lasted into the final days of the third quarter, and that the companies had pondered how to account for the deal so that each would gain accounting benefits and improve its quarterly earnings report.

> On September 30th, the final day of the third quarter, Qwest signed a deal to pay Enron $308 million for assets that included so-called dark fiber along a route from Salt Lake City to New Orleans. Dark fiber refers to idle network strands that require additional investments in electronic equipment before they can be put into service. In exchange, Enron agreed to pay Qwest $195.5 million for "lit wavelength," or active fiber optic cable services, over a 25 year period; each company exchanged checks for about $112 million around the close of the deal.
>
> Mr. Comack stated, "I can't conceive of any reason they would need more dark fiber in the U.S."
>
> The deal enabled Enron to book a sale and avoid recording a loss on the dark fiber assets, whose value in the open market had dropped far below the price of Enron's books.
>
> Qwest did not announce the Enron deal after it was made, although the company had regularly issued news releases for smaller deals, including a $20 million contract with Perot Systems Inc. on September 27.

> When Qwest announced third-quarter results on October 31, however, it boasted about the expansion of its fiber optic network, without naming Enron: "In a transaction with a significant business customer, Qwest purchased approximately $300 million of assets – including the 5,500 miles of domestic fiber routes, co-location space and power – to diversify and extend its network and to provide backup facilities."
>
> The news release continued: "This customer has also agreed to purchase high-speed optical network capacity from Qwest, with approximately $86 million in revenue recognized in the third quarter and additional future contracted revenue."
>
> "While the deal provided an $86 million increase to Qwest's reported revenues in the third quarter, it reduced reported earnings by an undisclosed amount," Mr. Gronbach, the Qwest spokesman, said.
>
> "It (the profit) was more than offset by the $112 million that Qwest paid to Enron in the quarter. The deal provided for Qwest to pay Enron another $83.5 million in two payments this year."

4. Global Crossing

145. Qwest also entered into fraudulent reciprocal transactions with Global Crossing. On September 17, 2002, the *Rocky Mountain News* published a memo written by Robin Wright, a top saleswoman of Global Crossing, to other Global Crossing executives on June 25, 2000, detailing what needed to be done for Qwest to book revenue quickly.

> A memo released last week discussing a fiber-optic capacity deal between Global Crossing and Qwest in mid-2001 is a "smoking gun," the Securities and Exchange Commission's former top accountant said Monday.
>
> "It appears Congress and the law enforcement agencies now have evidence that transactions between Qwest and Global Crossing were being cooked up to create revenues," said Lynn Turner, now director of Colorado State University's Center for Quality Financial Reporting.
>
> "Given the memo seems to call into question the 'real' economic substance of the transaction, as well as the accounting by Qwest, the 'smoking gun' appears to have found its way out of the closet," Turner added.

> A former Denver prosecutor also said the memo was "solid evidence" that some capacity swaps were schemes to prop up stock, while other former regulators and prosecutors stopped short of saying the memo is a smoking gun but said it certainly raises questions about the legitimacy of the swaps. All former regulators and prosecutors were provided with the memo before commenting.
>
> The memo, written by a top Global Crossing saleswoman to other Global Crossing executives on June 25, 2001, was released Friday by the House Energy and Commerce Committee as part of its investigation of Global Crossing and Qwest.
>
> In the memo, Robin Wright of Global Crossing told co-workers what needed to be done for Qwest to book revenues quickly.
>
> Wright also stated in the memo that "we have always agreed that the value . . . is what we paid for it, not fair market value . . . (but) now their accountants are insisting that is has to be fair market value." She said that Qwest and Global Crossing executives would meet the following day to "get a gentleman's agreement" on pricing.
>
> Critics say there was no reason to do swaps in 2001 other than to inflate revenue and profits, because the industry had a glut of capacity, prices were plummeting and short-term contracts for capacity were easy to get. Qwest was among the most aggressive in booking revenue from a long-term sale upfront, while spreading the expense of a purchase over the length of the agreement, generally 20 or 25 years.

C. <u>Inflation Of Phone Directory Services Revenue</u>

146. Qwest also inflated revenues by manipulating the results of its Qwest Dex phone directory services operation, recognizing revenues up-front, and changing formats and publication dates to make it appear that Qwest's revenue stream was greater than in fact was the case.

147. In 1999, Qwest manipulated current revenues by changing its policy to begin booking all directory revenues at the time of publication rather than over the 12-month life of the directory. As explained by an October 13, 2002 article in *Rocky Mountain News*:

> Qwest had changed its method of accounting for its Dex directories in 1999, booking all the revenue when the directory was published, rather than month by month over the life of the phone book. In 2000, it took advantage of the policy by changing publication schedules on its Dex phone books – some were published early – so two years' worth of revenue appeared in 2000. Other book's [sic] lives were extended to 13 months, instead of 12, adding more revenue.

148. To reiterate, to boost apparent revenues for 2000, Qwest changed certain directories from a 12-month to a 13-month format. Because customers paid on a per-monthly basis, and because Qwest recognized all revenue from the directory in the quarter in which it shipped, switching to a 13-month format meant that Qwest could (and did) inflate resulting revenues by approximately 8 percent. Similarly, Qwest shortened the time span of other directories to 11 months, so that it could publish (and recognize revenues from) a second directory in the same year. Accordingly, Qwest was able to record an additional $28 million in 2000 and $42 million in 2001.

D. <u>Qwest Discloses The Fraudulent Scheme In July 2002 After Revealing The SEC Investigation</u>

149. In February 2002, the SEC subpoenaed Qwest as part of an investigation into reciprocal transactions. Qwest's stock fell below $8 a share.

150. On February 14, 2002, Qwest drew down a $4 billion credit line to address liquidity concerns. Qwest stock dropped below $7.27 a share

151. In March 2002, the SEC began investigating Qwest's accounting treatment of long term contracts, particularly the 1999-2001 "swaps" with other carriers in an effort to inflate revenue and drive up the stock price. The SEC is also probing possible insider trading by top Qwest executives, who had sold more than $500 million in company stock during the period in which the swaps occurred.

152. On July 10, 2002, after previously denying a criminal investigation was occurring, Qwest finally admitted that it was the subject of a criminal

investigation being conducted by the Justice Department. Qwest announced that it had been notified of the investigation on July 9 by the U.S. Attorney's Office in Denver. The focus of the inquiry was accounting irregularities and possible insider trading by top executives.

153. On July 28, 2002, Qwest filed an 8-K with the SEC and issued a press release admitting the booking of false revenues from the sale of IRU's. The release stated:

> Based on the analysis to date, the company has determined that it has in some cases applied its accounting policies incorrectly with respect to certain optical capacity asset sale transactions in 1999, 2000 and 2001. Certain adjustments may be required to correct the period in which the revenue was recognized with respect to some transactions, and other adjustments may be required to reverse the recognition of revenue with respect to other transactions. In addition, further adjustments are required to account for certain sales of equipment in 2000 and 2001 that the company had previously determined had been recorded in error. In the fourth quarter of 2001, the company reduced revenue and adjusted EBITDA related to these equipment transactions. The company has also determined that in a limited number of transactions it did not properly account for certain expenses incurred for services from telecommunications providers in 2000 and 2001.

154. Significantly, the press release indicated that the revenue recognition policies implemented were approved by Andersen. The release further stated:

> The company analyzed its application of the revenue recognition policies approved by its previous auditor, Arthur Andersen LLP, with respect to optical capacity sales and concluded that those policies were incorrectly applied to optical capacity asset transactions in 1999, 2000 and 2001 which totaled approximately $1.16 billion in recognized revenue, and which represented approximately 18 percent of the optical capacity asset transactions in this period.
>
> Of this amount, revenue of $591 million was recognized by the company after June 30, 2000, the effective date of the merger of Qwest and U S WEST Inc. (the company that was deemed the accounting acquirer and whose financial statements were carried forward as those of the combined company). $571 million was recognized by Qwest before June 30, 2000 and therefore not included in the company's historical financial statements.

155. Qwest also disclosed equipment sales through which Qwest was engaging in reciprocal transactions for the sale of equipment and services. Qwest's July 28, 2002 press release describes this issue as follows:

> The expected restatement of the company's financial statements will also include adjustments for three transactions relating to the sale by the company of equipment to other parties. Two transactions involved related agreements to provide services to or buy services from the company. The variances that were identified were the result of the determination that the revenue and/or profit in these transactions were incorrectly recognized upfront and should be deferred. The total amount of revenue and adjusted EBITDA of all these equipment sales in 2000 and 2001 is as follows: (1) revenues of $100 million or 0.6 percent of total revenue, in 2000 and $183 million, or 0.9 percent of total revenue, in 2001 and (2) adjusted EBITDA of $80 million, which is 1.2 percent of adjusted EBITDA, in 2000 and $82 million, which is 1.1 percent of adjusted EBITDA, in 2001. The company has already reduced revenues and adjusted EBITDA by $73 million and $124 million, respectively, in the fourth quarter of 2001 to adjust for these transactions.

156. Qwest also announced on July 28, 2002 that it would be restating its financial statements for prior years. By disclosing that it will have to restate its financials, Qwest is admitting that its publicly issued financial statements for each of the restated periods were not prepared in conformity with GAAP, and that Qwest materially misstated its financial condition and results of operations. Under GAAP, the restatement of previously issued financial statements is reserved for circumstances where no lesser remedy is available. Under Accounting Principles Board Opinion No. 20, *Accounting Changes*, restatements are permitted, and are required, only to correct *material* accounting error or irregularities that existed at the time the financial statements were originally prepared and issued.

157. On August 19, 2002, Qwest filed an 8-K with the SEC and disclosed that it expected to include adjustments for equipment when it restates its financial statements:

> The most significant of these transactions involved KMC Telecom Holdings, Inc. ("KMC"). We sold equipment to

> KMC during the three and six months ended June 30, 2001 for an aggregate of $83 million and $148 million, respectively, in cash resulting in gross margins of $36 million and $81 million, respectively. At or about the same time as selling the equipment in 2001 to KMC, we entered into unconditional commitments to purchase facilities with KMC. These commitments aggregated $263 million as of June 30, 2002 for the 2001 transactions (along with $468 million as of June 30, 2002 for earlier similar transactions with KMC) and are included in the section called "Commitments" presented later in this Current Report on Form 8-K. The original adjustments for the two 2001 KMC transactions were made because of our determination that the profit in these transactions was incorrectly recognized upfront and should have been deferred and amortized over the remaining terms of the facilities management contracts. This was due to our determination that there was no practical manner by which to separate the terms of the equipment sale and facilities management contract. These transactions were adjusted during the fourth quarter of 2001 to reflect the proper accounting. We are continuing to discuss the accounting for these and certain earlier pre-Merger KMC transactions with KPMG.
>
> The other transaction occurring in the second quarter of 2001 involved a sale of equipment in which we recognized revenue in the three months ended June 30, 2001 of $31 million and gross margins of $5 million. We originally recorded these transactions on the basis of satisfying the criteria for a "bill and hold" transaction. We subsequently determined that these criteria had not been satisfied and the transaction should have been accounted for using long-term contract accounting and provided for that in the fourth quarter of 2001.

158. Qwest also disclosed the improper recognition of revenues and expenses from the Qwest Dex publishing directories.

159. On September 22, 2002, Qwest filed another 8-K with the SEC making further disclosures:

> Qwest Communications International Inc. (NYSE: Q) today announced further restatement of its 2000 and 2001 financial statements as a result of its ongoing analysis of the complex accounting policies and practices relating to revenue recognition and accounting treatment for exchanges and sales of optical capacity assets (IRUs). In restating its 2000 and 2001 financial statements with respect to these matters to be in conformance with generally accepted accounting principles, the company will reverse $950 million in revenues and related costs related to exchanges of optical capacity assets previously

recognized. Some of the transactions included in this restatement were the subject of the company's July 28, 2002, announcement of determinations reached as of that date.

The company historically accounted for contemporaneous exchanges of optical capacity assets based on accounting policies approved by its previous auditor Arthur Andersen LLP. After analyzing its prior policies and practices, including the underlying accounting records, and in consultation with its new auditors, KPMG LLP, the company has concluded its policies and practices do not support the accounting treatment to allow for recognition of revenue from these exchange transactions. In conducting its analysis, the company considered discussions it had in late July 2002 with the staff of the Office of the Chief Accountant of the Securities and Exchange Commission.

The company also historically accounted for its sales of optical capacity assets for cash to third parties based on accounting policies approved by Arthur Andersen. Qwest has preliminarily concluded in consultation with KPMG that its accounting practices intended to follow these policies do not support the historical accounting treatment with respect to these optical capacity asset sales. The accounting for each of these transactions is being reviewed to assess whether and to what extent a restatement is required. Consequently, in connection with the company's restatement of its financial statements for 2000 and 2001 the approximately $531 million in revenue previously recognized from these sales of optical capacity assets for cash may require adjustment; however, the magnitude of the adjustments and the periods affected have not yet been determined.

This announcement relates to optical capacity asset transactions recorded in periods following the merger of Qwest and U S WEST, Inc. on June 30, 2000. Approximately $1.48 billion in total revenue was recognized in these periods from all IRU transactions and is made up of the $950 million from exchanges of optical capacity assets and the $531 million from sales of optical capacity assets for cash.

Out of the $1.48 billion in total revenue, $1.016 billion and $464 million were recognized in 2001 and 2000, respectively. These represented 5.2% and 2.8 % of total reported revenue in 2001 and 2000, respectively. The company recognized $490 million and $231 million of gross margin from optical capacity asset transactions in 2001 and 2000, respectively, which represented 6.7% and 3.3% of total reported adjusted EBITDA in 2001 and 2000, respectively. Of the total amounts recognized from all optical capacity asset transactions in each year, the company has concluded that $685 million and $265 million in revenues from exchanges of optical capacity assets will be reversed in 2001 and 2000, respectively, and $331 million and $200 million in sales of optical capacity assets for cash in those respective periods are subject to review to determine whether adjustment is required. The amounts for 2000 represent only those transactions entered into after the merger and the percentages are based upon the full year results as reported in the company's annual report on Form 10-K. The company has previously disclosed that it does not anticipate any sales of optical capacity assets in 2002 that would be impacted by the announcement today.

The restatement and possible adjustment of revenues described in this announcement do not include revenues reported by Qwest with respect to optical capacity asset transactions before the merger. Qwest generally applied these same accounting policies and practices with respect to these IRU transactions. The total revenue recognized in optical capacity asset transactions in 1999 and 2000 prior to the merger is approximately $1.32 billion. The revenue recognized from pre-merger optical capacity asset transactions are not reflected in the company's financial statements since U S WEST was deemed the accounting acquirer in the merger.

The restatement announced today includes some of the optical capacity asset transactions reflected in the $1.16 billion of revenues from similar transactions in 1999, 2000 and 2001 covered in the company's July 28 announcement. Out of that amount, the company announced that $591 million in post-merger revenues was the subject of restatement by the company as of that date. This announcement includes an additional $894 million in post-merger revenues subject to restatement from additional transactions not covered in the previous announcement.

160. On October 28, 2002, Qwest announced the additional results of its analysis of the accounting for IRUs:

[I]n consultation with its auditor KPMG LLP ("KPMG"), it has completed its analysis and concluded that for accounting purposes it will treat sales of optical capacity assets (commonly known as "IRUs") for cash as operating leases and recognize the revenue from these assets over the life of the IRUs. The company has concluded that its policies and practices for determining the value of the various elements of the fees earned in connection with the sales of optical capacity assets for cash did not support the accounting treatment. As a result, the company concluded that it should defer the

> $531 million of revenue previously recognized on such sales over the life of the underlying agreements.
>
> This announcement relates to optical capacity asset transactions recorded in periods following the merger of Qwest and U S WEST, Inc. ("U S WEST") on June 30, 2000. Approximately $1.48 billion in total revenue was recognized in these periods from all IRU transactions and, as previously announced, is made up of the $950 million from exchanges of optical capacity assets and the $531 million from sales of optical capacity assets for cash. As previously announced, the company will reverse the $950 million in revenues and related costs ($685 million and $265 million in 2001 and 2000, respectively) related to the exchange transactions. Of the $531 million of revenue that the company announced today will be deferred, $331 million and $200 million of sales of optical capacity assets were recognized in 2001 and 2000, respectively. The company historically accounted for sales of optical capacity assets for cash based on accounting policies approved by its previous auditor, Arthur Andersen LLP ("Andersen").

161. As recently disclosed in an 8-K filed by Qwest on November 14, 2002, during the period following the U S West merger, i.e., from June 2000 through 2001, Qwest improperly recognized approximately $1.5 billion in revenues from IRU transactions. Approximately $1.3 billion in pre-merger IRU transactions are still being audited.

E. <u>Qwest's Stock Plummets As Wrongdoings Become Known</u>

162. As these improper manipulations of Qwest's reported revenues, losses and profits became known, and in the wake of investigations by the SEC and U.S. Attorney into Qwest's accounting practices, Qwest found it increasingly difficult to obtain needed credit, and its stock price continued to drop.

VII. <u>DEFENDANTS' DIRECT PARTICIPATION IN QWEST'S FRAUD</u>

A. <u>The Individual Defendants</u>

1. The Board of Directors

163. Qwest's board of directors, including Defendants Nacchio, Anschutz, Barrett, and Khosla, had full knowledge of the true financial condition of Qwest. Andersen made presentations to the entire board about the accounting methods

used by Qwest. For instance, in October 2000, as reported by the October 3, 2002 *Rocky Mountain News*, Andersen informed the board that the SEC was "vigorously challenging" the immediate recognition of revenue on long-term IRU transactions.

164. In August 2001, Defendant Szeliga had publicly (and falsely) denied that Qwest had used such non-cash IRU transactions to increase revenues. In fact, according to the article quoted below, she knew her statement was false because she had only 24 hours earlier written a confidential memorandum to the contrary:

> On August 3, 2001, TheStreet.com published an interview with Qwest's CFO, Robin Szeliga, on the subject of how Qwest accounts for IRU transactions. Ms. Szeliga was quoted as flatly denying that any of the company's IRU transactions were nonmonetary in nature, stating, according to the article, that "<u>all IRUs are cash transactions</u>" (emphasis added).
>
> Yet 24 hours earlier, Ms. Szeliga had written and distributed her "Confidential" memo on the specific subject of IRU accounting. Among the eight recipients of the two-page document was Qwest's president and chief operating officer, Afshin Mohebbi.
>
> In the memo, Ms. Szeliga expressed concern over a "significant number" of what she termed "nonmonetary or two-way" IRU transactions that Qwest had entered into in "the past several quarters," and declared a new rule for the future: henceforth she personally would have to sign off on "ANY [sic] nonmonetary" IRU transaction in which there is a "buy-side."

Christopher Byron, <u>Qwest Insiders Share Recipe For Revenue Growth</u>, Redherring.Com, Mar. 11, 2002.

2. The Audit Committee

165. The members of Qwest's Audit Committee had numerous discussions with Andersen about Qwest's accounting methods and met regularly to discuss accounting issues. Defendant Szeliga, on September 24, 2002, testified before the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce that "Arthur Andersen also periodically presented its findings, views and opinions on accounting issues to the audit committee of the board of

directors." Mark Iwan, the lead auditor on the Andersen audit team, discussed the accounting for IRUs on numerous occasions with the Audit Committee. *Business Week* , Nov. 4, 2001. For example, in October 2000, Iwan told Qwest's Audit Committee that its policies on "accounting for network capacity sales were one of the company's 'key' financial reporting risks." *Rocky Mountain News*, October 3, 2002. The following October, "Iwan told the board's audit committee that eight of the 19 Qwest accounting policies Andersen evaluated were 'aggressive,' and two were close to 'unacceptable.' Many elements of Qwest's financial statements, including but not limited to the capacity sales were 'maximum risk.'" *Id*.

3. Nacchio and Anschutz

166. In addition to the information Nacchio and Anshutz learned through Qwest board meetings and from information disclosed to them by the Audit Committee, Nacchio and Anschutz were involved in all the major decisions of the company and spoke with each other regularly. Through their positions and involvement in Qwest, they knew of and encouraged the schemes in order "to make the numbers or else."

167. For instance, since Defendant Anschutz founded Qwest in 1995, he has been the ultimate decision-maker. Anschutz is the largest shareholder of Qwest, owning 18 percent of the shares. At one time, he had owned 86% of the company, but he has sold over 40 million shares of stock for over $1.9 billion in proceeds. He has controlled the board of directors, appointing those loyal to him. Qwest's statement on Form S-1 filed with the SEC on April 18, 1997 stated, "Mr. Anschutz will have the power to elect all the directors of the Company and to control the vote on all other matters." Anschutz is the head of Qwest's compensation committee.

168. Defendant Nacchio, appearing before Oversight and Investigations Subcommittee of the House Energy and Commerce Committee on October 1, 2002, testified that Anschutz was substantially involved in all major decisions:

> Phil Anschutz and I were close friends for five and a half years. I spoke to Phil two to three times a week. Every major decision I made at this firm, I sought his counsel. In the old Qwest, he was the majority owner. He headed the executive committee. I always went to Phil Anschutz when I needed counsel. Many times, I would get calls from Phil just to find out what was going on. Phil was very involved. He was helpful to me. His vision, combined with my vision, helped us create Qwest and he was co-chair of the board. For board matters, I went to Phil. Phil managed the relationship with the board.
>
> . . . .
>
> This board of directors for which I was co-chairman – I know for the purposes of this meeting I'm not the chairman, but when we ran the company I was co-chairman. Mr. Anschutz manages the board.

169. Anschutz also used Qwest for his personal benefit, which created conflicts of interest in direct violation of his fiduciary duties. For example, in April 2002, Qwest announced the closing of Qwest Digital Media. Qwest Digital Media had been created in 1999 as a joint venture project between Anschutz and Qwest. Qwest contributed $85 million to the venture, while Anschutz invested an undisclosed amount in the form of television production assets. In 2000, Anschutz received $48 million and 25% of the equity in QDM.

170. Notwithstanding this knowledge, Nacchio and Anschutz made material misrepresentations and omissions as particularized above, by signing statements filed with the SEC and making public statements with the intent of inducing individuals and entities like CalSTRS to invest in Qwest.

4. Other Individual Defendants

171. Defendant Mohebbi had knowledge of and encouraged Qwest's fraudulent deals. For example, according to the House Energy & Commerce Committee, in 2000, Defendant Mohebbi told employees to put through a questionable sale of fiber optic capacity and offered to "take the fall" if the company was caught. In December 2000, Mohebbi wrote an e-mail to Cable & Wireless assuring them about a secret side deal between Qwest and Cable &

Wireless that, if known, would not have allowed Qwest to recognize all revenue immediately from the primary contract. He also participated in other side deals and swaps.

172. As Qwest's Chief Financial Officer from 1997 until February 2001, Defendant Woodruff, formerly a partner in a Big Five accounting firm, was responsible for financial planning and analysis, financial operations, internal audit, corporate strategy, accounting systems and financial reporting. He participated in making the decisions about the fraudulent revenue recognition policies. Despite this knowledge, he made false and misleading statements to Plaintiff and the public about Qwest's financial condition.

173. As Qwest's Interim and then permanent Chief Financial Officer from March 2001 through July 2002, Defendant Szeliga was responsible for financial planning and analysis, financial operations, internal audit, corporate strategy, accounting systems and financial reporting. Before March 2001, she was Senior Vice President of Finance. According to testimony before the House Committee and documents, Defendant Szeliga was aware of the fraudulent swap deals and side agreements by May 2001, and knew that these deals were accounted for improperly in Qwest's financial statements, yet approved the false financial statements which were released to Plaintiff and the public.

B. <u>The Bank Defendants</u>

174. The Bank Defendants sold Qwest's debt and equity securities to the public, while also creating and financing many of the transactions that were used to manipulate Qwest's financial results and also to provide millions of dollars of loans to Qwest. The Bank Defendants had extensive dealings with Qwest over the years, and participated in multiple offerings and other financial transactions on behalf of Qwest and its subsidiaries and affiliates.

175. Pursuant to their due diligence obligations, the Bank Defendants were required to and did review the financial statements of Qwest, including those

included in or referred to in the registration statements for these debt securities. The registration statements prepared and reviewed by the Bank Defendants and filed with the SEC on the securities sold to Plaintiff were materially false and misleading.

1. CitiGroup And Salomon

176. In the late 1990s and early part of this century, Salomon emerged as the leader in public offerings for telecommunications deals. Salomon has collected over $800 million in underwriting telecom stocks and bonds and $278 million for providing merger advice since 1997.

177. Salomon and Qwest had a close relationship, which generated millions of dollars of fees for Salomon and raised millions of dollars for Qwest. Between January 1998 and July 2001, Salomon advised Qwest on about 18 investment banking deals, which earned Salomon over $30 million. Both companies depended upon each other's success to drive their businesses.

a. Salomon made sure it had close relationships with companies by providing preferred executives with stock in IPOs

178. Salomon was able to earn these enormous investment fees because it engaged in a *quid pro quo* with certain executives whereby Salomon provided shares in "hot" initial public offerings ("IPOs") to executives whose favor they sought, such as Anschutz and Nacchio, in return for the investment banking business of those executives' companies. Salomon could ensure that the public offering would be successful because it knew that Jack Grubman, its top telecommunications securities analyst, would provide favorable ratings of the company.

179. According to a September 30, 2002 complaint filed by the Attorney General of New York against Anschutz, Nacchio and others, and information provided by Citibank to Congressional investigators, Salomon and its predecessors engaged in a practice called "spinning," which involved Salomon providing

favored executives with nearly risk-free shares of stock in companies which were about to go public. In a *quid pro quo*, the executives reaped enormous profits from the selling of the IPO stock and the executives selected Salomon as their company's investment bank for their own public offerings.

180. On August 26 and 30, 2002, Citibank produced documents in response to a subpoena by the House Committee on Financial Services which disclosed the executives who received this favorable treatment. The documents demonstrate that these executives made over $18 million in profits due to these IPO deals. Anschutz and Nacchio of Qwest both received IPO stock and made substantial profits. (Anschutz made about $5 million while Nacchio made over $1 million.)

181. As part of the *quid pro quo*, Salomon made sure that its purportedly neutral investment analysts, who rated companies for stock investors, gave favorable ratings to its investment banking clients. Grubman, during his testimony to the House Committee on Financial Services on July 8, 2002, explained the work that an analyst is supposed to perform:

> As an equity research analyst for the past seventeen years, my job has been to make judgments about the future prospects of companies in the telecommunications industry. Assisted by my research team, I render opinions and make forecasts about the industry and individual companies using publicly available information to develop financial models, earnings estimates, and price targets for the companies we follow. I also analyze industry trends, and seek to forecast the impact on individual stock prices of such variables as the overall health of national and local economies, regulatory policy and the supply and demand balance for telecommunications services. And, like all research analysts, I talk regularly to company managers, customers, suppliers, competitors and investors.

182. While purportedly neutral and walled off from the investment banking side of the business, Salomon analysts are actually partisans of the clients that they value. There is tremendous pressure on the analysts, including financial incentives, to provide high ratings for investment banking clients, especially near

the time of public offerings. Grubman alluded to the pressure during his testimony before the House Committee on Financial Services that companies will not use an investment bank if the bank's analysts provide negative ratings. At Salomon, the structure of the analyst's compensation is tied to the success of the investment banking side.

b. *Salomon's Jack Grubman was a cheerleader for Qwest and other investment banking clients of his firm*

183. Until leaving Salomon in August of 2002, Grubman was Salomon's top telecommunications analyst, whose opinions were highly valued by the investment community. In 1994, Grubman joined Salomon as a telecommunications analyst from Paine Webber.

184. Grubman's ratings could make or break a company. Money managers referred to Grubman as the "ax" – the most influential analyst in his sector. "When Grubman said wonderful things about a company, it was like a narcotic – everybody wanted it," recalled Elliot Dorbian, a former broker at Salomon. "He walked around like he was a god. And it was perceived by the industry that he was a god."

185. Salomon held Grubman out as an independent analyst who provided information upon which the investing public could rely. In fact, Grubman was a partisan supporter of companies so that Salomon and he could reap millions of dollars in rewards. He continued to tout stock even as the companies were experiencing severe financial difficulties. He gave favorable ratings to such companies as WorldCom, Multimedia, XO Communications, Metromedia Fiber Network and McLeod USA. Salomon and Grubman are being investigated for Grubman's reversing a negative rating on AT&T shortly before Salomon won a lead role in the $10.6 billion IPO of AT&T's wireless unit. According to an article in the November 17, 2002 *New York Times*, Citicorp's Chairman and CEO,

Sanford Weill, helped Grubman get his twins into a prestigious nursery school as a *quid pro quo*.

186. Grubman's compensation, which reached $20 million a year his last few years at Salomon, was tied to Salomon's telecommunications business, including its deals with Qwest. According to the *New York Times News Service*:

> "[a] former analyst at the firm [Salomon], Grubman's pay was tied specifically to the deals that the firm did in telecommunications. 'I remember meeting with these guys and they would say, "Here's how much we're paying you, deal by deal,"' this person said. 'There was a formula.'"

187. Grubman had a close relationship with Qwest and its upper management. Nacchio and Grubman had worked together at AT&T. Grubman introduced Nacchio to Anschutz, which led to Nacchio's hiring at Qwest. Grubman gave strategic planning advice to Qwest, including during at least one board meeting in 1999, and advised Qwest on the U S West merger.

c. *Grubman touts Qwest stock notwithstanding his knowledge of adverse information about Qwest's true financial condition*

188. Between 1999 and 2002, Grubman and Salomon issued dozens of analyst reports, including analyst reports which made false representations and omitted material facts. In issuing these reports, Salomon knew that they would serve to increase or inflate the price at which Qwest stock traded, compared to the price at which it would have traded had the Salomon analyst reports not been issued. Salomon issued these reports with the intention of increasing and inflating the price at which Qwest stock would trade and as part of its effort to continue to obtain substantial investment banking and advisory fees.

d. *Lehman, Morgan Securities and Merrill*

189. Lehman, Morgan Securities and Merrill each also had investment departments that issued favorable ratings about Qwest. These analysts also had non-public, confidential negative information about Qwest. In issuing these reports, Lehman, Morgan Securities and Merrill each knew that they would serve

to increase or inflate the price at which Qwest stock traded, compared to the price it would have traded had the analyst report not been issued. Lehman, Morgan Securities and Merrill issued these reports with the intention of increasing and inflating the price at which Qwest stock would trade and as part of their effort to continue to obtain substantial investment banking and advisory fees.

e. *Salomon, Lehman, Morgan Securities and Merrill made misrepresentations and omitted material facts to obtain lucrative fees from Qwest*

190. When Salomon, Lehman, Morgan Securities and Merrill issued their Qwest analyst reports, they had in their possession material, adverse, and non-public information regarding their role in Qwest's investment banking business and they knew that this information was adverse, non-public information material to the investment decisions of reasonable investors.

191. When Salomon, Lehman, Morgan Securities, Merrill issued their Qwest analyst reports, they knew that issuing the reports would, as had their prior reports, serve to increase or inflate the price at which Qwest stock traded, compared to the price it would have traded had they not issued the Qwest Analyst report. These Bank Defendants issued the Qwest analyst reports with the intention of increasing and inflating the price at which Qwest stock would trade.

192. These Bank Defendants issued their false and misleading analyst reports as part of their attempts to obtain substantial investment banking and advisory fees.

193. In each of its Qwest reports, these Bank Defendants stated a "reason for the report." The stated reason for the report was false and misleading because they failed to disclose that the true reason they issued each report was to assist them in their efforts to obtain investment banking fees.

194. These Bank Defendants' analyst reports on Qwest were false and misleading because they failed to disclose in those analyst reports their basis for deciding which companies to include in the reports and what to say in those

reports. The decision was based on the impact their coverage would have on their ability to obtain underwriting and investment banking engagements from those companies or others.

195. These Bank Defendants' "buy" recommendations in their Qwest analyst reports were false and misleading because they failed to disclose that they had a policy and practice of issuing more positive analyst reports on telecommunications companies that were their clients. These Bank Defendants adhered to that policy and practice regardless of whether there was any rational economic basis for its recommendations. These Bank Defendants made the "buy" recommendations because they knew that assigning an unfavorable rating to the telecommunications company would jeopardize their ability to obtain underwriting and/or investment advisory engagements from these companies or others. The Qwest reports were false and misleading because these Bank Defendants did not disclose the existence of, and their reasons for, their true rating policies and practices.

196. The Qwest analyst reports were false and misleading because they failed to disclose that their "buy" recommendations of Qwest stock lacked a reasonable basis in fact, and were, in reality, undisclosed attempts to inflate the value of Qwest stock based on the momentum of the market with no rational economic reason why the stock should trade at its current price and no rational economic reason why the stock's price should continue to rise.

197. All of these Bank Defendants' Qwest analyst reports were false and misleading because (1) they failed to disclose the significant and material conflicts of interest which these Bank Defendants had when they issued analyst reports on Qwest and (2) failed to disclose that these reports supported Salomon's investment bankers in their quest for fees.

2. The Bank Defendants Loan Money to Qwest And Then Protect Their Loans By Assisting In Qwest's Note Offerings

198. Defendants Salomon, CitiGroup, Lehman Brothers, Banc of America, Bank of America, Morgan Chase, Morgan Securities and Merrill Lynch provided investment banking, advisory and general finance and banking services to Qwest. Each of these Bank Defendants had a common interest in creating the illusion that Qwest was a company worthy of investment grade ranking because they knew that the only way that they would be repaid the loans and continue to receive millions in investment and advisory fees was if Qwest continued to be perceived as a successful company.

a. The loans

199. Beginning as early as 1999, Defendant Bank of America's predecessor, NationsBank and other banks loaned millions of dollars to Qwest. By March of 2000, Bank of America, as Administrative Agent; Banc of America and Morgan, as Joint Lead Arrangers and Joint Book-Runners; Salomon, as Co-Arranger; Chase Manhattan Bank, as Syndication Agent; and Citibank, as Co-Documentation Agent had also extended credit to Qwest.

200. In the loan agreements, the lenders had the right to review the books, files and records, conduct tests and investigations, and to discuss Qwest's finances with creditors, directors, officers, employees and independent auditors. As part of their due diligence, the Bank Defendants conducted investigations of Qwest's finances on a periodic basis. As a result of their investigations, they knew that Qwest had serious financial problems and that its revenues were being overstated.

b. The note offerings

201. To raise money, Qwest issued notes, assisted by the Bank Defendants.

(1) 7.9% Note offering

202. Qwest offered 7.9% exchangeable notes on January 17, 2001, due 2010, which were registered under the Securities Act of 1933. Defendants

Salomon and Lehman are the representatives of the Initial Purchasers. Defendants Salomon, Lehman, Morgan Chase, Banc of America and Merrill are the Initial Purchasers. These Bank Defendants consented to have their names in the registration statement for the 7.9% Notes. Defendant Andersen consented to have its unqualified audit opinion for 1999 to 2000 in the registration statement for the 7.9% Notes. As such, they participated in the solicitation, offering, and sale of the 7.9% Notes to the investing public pursuant to the registration statement.

(2) 7.75% Note offering

203. Qwest offered 7.75% exchangeable notes due 2031, which were registered under the Securities Act of 1933. Defendants Banc of America and Morgan Chase are the representatives of the Initial Purchasers. Defendants Banc of America, Morgan Chase, Merrill, Salomon and Lehman are the Initial Purchasers. These Bank Defendants consented to have their name in the registration statement for the 7.75% Notes. Defendant Andersen consented to have its unqualified audit opinion from 1999 to 2001 in the registration statement for the 7.75% Notes. As such, they participated in the solicitation, offering, and sale of the 7.75% Notes to the investing public pursuant to the registration statement.

(3) 7.25% note offering

204. Qwest offered 7.25% exchangeable notes due 2011, which were registered under the Securities Act of 1933. Defendants Banc of America and Morgan Chase are the representatives of the Initial Purchasers. Defendants Banc of America, Morgan Chase, Merrill, Salomon and Lehman are the Initial Purchasers. These Bank Defendants consented to have their name in the registration statement for the 7.25% Notes. Defendant Andersen consented to have its unqualified audit opinion from 1999 to 2001 in the registration statement for the 7.25% Notes. As such, they participated in the solicitation, offering, and sale of the notes to the investing public pursuant to the registration statement.

(4) 7% note offering

205. The Company offered 7% exchangeable notes due 2009, which were registered under the Securities Act of 1933. Defendants Merrill and Lehman are the representatives of the Initial Purchasers. Defendants Merrill, Lehman, Morgan Chase, and Salomon are the Initial Purchasers. These Bank Defendants consented to have their name in the registration statement for the 7% Notes. Defendant Andersen consented to have its unqualified audit opinion from 2000 to 2001 in the registration statement for the 7% Notes. As such, they participated in the solicitation, offering, and sale of the notes to the investing public pursuant to the registration statement.

206. The registration statements for the foregoing note offerings, at the time they were issued and became effective, were inaccurate and misleading, contained untrue statements of material fact and/or omitted to state material facts necessary to make the statements made therein not misleading, as set forth above.

207. Due to their role in the note offerings, the Bank Defendants were responsible for the contents and dissemination of the registration statements, they made representations and omitted material facts to investors about the offering, and are liable for any material misrepresentations or omissions contained therein. Based upon their due diligence arising from their roles as lenders, advisors and investment bankers, the Bank Defendants knew that the statements contained in the registration statements were not true, that they omitted material facts, and were materially misleading. They knew that investors would be misled when they purchased Qwest notes and stock, but nevertheless made the misrepresentations to sell the notes and stock.

208. Additionally, in order to maintain the stock's price, the analysts at the Bank Defendants' touted the stock, as set forth above, despite their knowledge of the falsity of their statements and their knowing omissions of material facts.

C. Andersen

1. Andersen Received Millions Of Dollars In Fees By Providing Audit, Tax, And Consulting Advice to Qwest

209. Andersen was the purportedly independent auditor for Qwest from 1999 until 2002. During that time, Andersen provided unqualified audit opinions on the consolidated financial statements for fiscal year end 1999, 2000 and 2001, reviewed interim statements, and provided tax and audit advice. Andersen consented to having its unqualified opinion included with SEC filings, including Proxy Statements. Andersen earned millions of dollars in fees from engagements. Andersen earned these fees from auditing and other services such as consulting and tax. As the independent auditor for Qwest, Andersen created a conflict of interest by accepting consulting and tax fees and should have divested itself of all non-audit services to maintain its professional independence.

2. Responsibilities Of An Independent Auditor

210. The responsibilities and functions of an independent auditor include the following:

> "The objective of the ordinary audit of financial statements by the independent auditor is the expression of an opinion on the fairness with which they present, in all material respects, financial position, results of operations and cash flows, in conformity with generally accepted accounting principles." (AICPA Auditing Standards ("AU") 110.01)
>
> "The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud." (AU 110.02)
>
> "The professional qualifications required of the independent auditor are those of a person with the education and experience to practice as such." (AU 110.04)

211. The independent auditor must also comply with professional training and proficiency rules, including the following:

> "In the performance of the audit which leads to an opinion, the independent auditor holds itself out as one

> who is proficient in accounting and auditing." (AU 210.03)
>
> "The independent auditor's formal education and professional experience compliment one another; each auditor exercising authority upon an engagement should weigh these attributes in determining the extent of his or her supervision of the subordinates and review of their work. It should be recognized that the training of a professional person includes a continual awareness of developments taking place in business and in his or her profession." (AU 210.04)
>
> "In the course of his or her day-to-day practice, the independent auditor encounters a wide range of judgment on the part of management, varying from true objective judgment to the occasional extreme and deliberate misstatement. He or she is retained to audit and report upon financial statements of a business because, through training and experience, he or she has become skilled in accounting and auditing and has acquired the ability to consider objectively and to exercise independent judgment with respect to the information recorded in books of account or otherwise disclosed by his or her audit." (AU 210.05)

212. The independent auditor must comply with the rules of independence, including the following:

> "the auditor must be independent.....he must be without bias with respect to the client since otherwise he would lack that impartiality necessary for the dependability of his findings, however excellent his technical proficiency may be. However, independence does not imply the attitude of a prosecutor but rather a judicial impartiality that recognizes an obligation for fairness not only to management and owners of a business but also to creditors and those who may otherwise rely (in part, at least) upon the independent auditor's report, as in the case of prospective owners or creditors." (AU 220.02)

213. Andersen was aware of these AU provisions. Andersen also knew that there were increased responsibilities for audit committees and independent auditors because of concerns about misstatements in financial statements. In 1998 and 2000, Andersen published a White Paper entitled "Arthur Andersen, New Responsibilities and Requirements for Audit Committees, Global Best Practices for Audit Committee" (attached as Appendix B to Blackman, Salan editors, *Audit*

Committees: Regulation and Practice (Aspen Law and Business 2002)). In the introduction of the White Paper, Andersen states:

New responsibilities for a new century– an introduction

> "As we start this new century, audit committees face new responsibilities and requirements. They must meet new standards for membership, independence, and financial literacy. They must comply with new requirements to draft or update their chargers and certify their compliance with the rules. And most importantly, they have a new obligation each quarter to discuss with the independent auditor the quality of the company's financial reporting. . . . [¶] These new standards are a mandate for audit committees (and through them, auditors) to raise the bar and enhance their effectiveness as investors' representatives in financial reporting oversight. Audit committees can respond to these changes in many ways to build substantive improvements into their processes."
> *Id.*, page 4 (App B-6).

The White Paper also recognizes that the independent auditors must meet with the audit committee:

> "*Discussion of the quality of financial reporting: the new requirement ASB requirement* In connection with each SEC audit engagement, independent auditors are required to discuss with the audit committee the auditors' judgments about the quality, not just the acceptability, of the company's accounting principles as applies in its financial reporting (the annual quality discussion)."
> *Id*. at 9 (App B-11). *See also id*. at 13 (App B-15)
>
> (Amended Statement of Auditing Standards (SAS) 61 requires auditor to meet with audit committee to discuss quality not just the acceptability of a company's accounting principles. Andersen also recognizes that under new SEC requirements, "independent auditors are required to review interim financial statements before the company files its Form 10-Q or 10-QSB." *Id*. at 11
>
> (App. B-13); *see also id*. at 49 (App. B-51) re SAS 71, Interim Financial Information).

214. Andersen, in contracting to perform its audit of Qwest's financial statements, assumed all of the responsibilities and obligations set forth in the preceding paragraphs. Andersen holds itself out as an expert in auditing and accounting rules regarding the telecommunications industry. In addition to Qwest,

Andersen's clients included WorldCom, Global Crossing, Level 3 Communications, FLAG Telecom Holdings and Genuity.

215. As part of its planning for and implementation of various engagements for Qwest, Andersen was required to be thoroughly familiar with the nature of Qwest's business, the manner in which senior management ran the company, the internal control environment at the company, and the existence of any unusually high audit risks at Qwest.

3. Andersen Knew of the Improper Accounting Scheme

216. Andersen knew about the improper accounting scheme because Andersen gave the other Defendants advice on how to implement the scheme, which could not have occurred without Andersen's advice and the "cover" of its credibility. According to an October 12, 2002 article in the *Rocky Mountain News*, Andersen published a series of White Papers starting in August 1999 and revised at least four times. In the first White Paper, Andersen explained how Qwest and other companies could recognize revenue immediately from IRUs, even though FASB Interpretation No. 43 required that IRUs be treated as real estate leases where revenue would have to be recorded over the term of the contract. Andersen advised Qwest on how to implement this scheme and other schemes to inflate revenue and minimize expenses.

217. Andersen knew that this scheme violated GAAP, but nevertheless encouraged Qwest to follow it. According to Qwest's July 28, 2002 press release, Andersen had full knowledge and approved of its accounting:

> The company analyzed its application of the revenue recognition policies approved by its previous auditor, Arthur Andersen LLP, with respect to optical capacity sales and concluded that those policies were incorrectly applied to optical capacity asset transactions in 1999, 2000 and 2001 which totaled approximately $1.16 billion in recognized revenue, and which represented approximately 18 percent of the optical capacity asset transactions in this period.

218. In its October 28, 2002 press release disclosing further wrongdoing, Qwest stated, "The company historically accounted for sales of optical capacity assets for cash based on accounting principles approved by its previous auditor, Arthur Andersen LLP ('Andersen').

219. According to March 21, 2002 testimony offered by Defendant Mohebbi, President and Chief Operating Officer of Qwest, Andersen reviewed the IRU transactions each quarter.

220. Defendant Szeliga testified on September 4, 2002 before the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce that:

> Qwest's auditors, Arthur Andersen, advised us in our financial reporting and accounting. Arthur Andersen worked closely and on an ongoing basis with Qwest's controller and technical accounting group. In addition Arthur Andersen performed annual audits and quarterly pre-issuance reviews. Arthur Andersen also periodically presented its findings, views, and opinions on accounting issues to the audit committee of the board of directors.
>
> When significant accounting issues arise, the technical accounting team reviewed those issues with Arthur Andersen staff to obtain their advice and guidance. When appropriate those issues were brought to the attention of Qwest's audit committee and Qwest's internal audit and legal department.

221. In October 2000, Andersen informed the Qwest board of directors that the SEC was "vigorously" challenging the accounting methods followed by Qwest. Based upon its own presentations to Qwest's Audit Committee in October 2001, Andersen knew that eight of nineteen of Qwest's accounting policies were aggressive, two were close to "unacceptable" and many elements of its financial statements were "maximum risk." Notwithstanding this knowledge, Andersen continued to audit Qwest's financial statements, allow the policies to continue, and provide unqualified opinions on Qwest's financial statements.

4. Andersen Made False Representations About Qwest's Financial Statements

222. Andersen violated its professional responsibilities, and knowingly or recklessly participated with Qwest in its improper accounting in order to artificially boost Qwest's reported revenue and profits. Although Andersen was aware that Qwest was improperly inflating revenue and that the statements were in violation of GAAP, Andersen provided a "clean" audit opinion for the company's year-end financial statements for 1999, 2000 and 2001 in violation of Generally Accepted Auditing Standards ("GAAS"). For each of these years, Andersen consented to its audit opinion being filed with Qwest's 10-K, registration statements and other public documents. Andersen participated in the fraud in order to continue earning lucrative fees for the auditing and other services that it provided for Qwest. Based upon these facts, Andersen had knowledge and/or reckless disregard of the fraud.

223. Under professional standards, Andersen had a duty to withdraw from the engagement upon discovering the fraud, but instead, it participated in and encouraged the fraud. In an 8-K that Qwest filed with the SEC disclosing the change of auditors, Andersen confirmed that there had been no disagreements between Andersen and Qwest on any matters of accounting principles or practices, financial statement disclosure, or auditing scope of procedures.

5. Andersen Violated Its Professional Obligations

224. As a result of Andersen's violation of its obligations, and its knowing participation in the scheme to defraud, Qwest's shareholders, the public, and the SEC were given materially false information concerning Qwest's revenues and earnings.

225. Andersen, knew, or except for its deliberate disregard of facts, would have known that it (1) had not performed its audit of Qwest's financial statements for the year ended 1999, 2000 and 2001 in compliance with GAAS; (2) it never

should have issued "unqualified" audit reports on Qwest's year-end financial statements for 1999, 2000 and 2001; and (3) its audit report on Qwest's financial statements for year end 1999, 2000 and 2001 contained materially misleading financial information.

226. The auditor's standard unqualified report states that the financial statements present fairly, in all material respects, an entity's financial position, results of operations, and cash flows in conformity with GAAP. This conclusion may be expressed only when the auditor has formed such an opinion on the basis of an audit performed in accordance with GAAS. (AU 508.07).

227. In light of Andersen's special knowledge and expertise and its awareness of Qwest's activities, Andersen's total abdication of professional skepticism by encouraging Qwest's improper recognition of revenue resulted in the issuance of an unqualified audit opinion on financial statements that were known by Andersen to be materially misstated.

228. Andersen made untrue and misleading statements of material facts and omitted material facts necessary in order to make its statements regarding Qwest's financial statements not misleading. Specifically, Andersen knew that Qwest's annual financial results for fiscal years 1999, 2000 and 2001 were materially overstated and were not presented in conformity with GAAP. Andersen's audits were not performed in accordance with GAAS or AICPA standards.

229. Throughout the course of its financial reports, Qwest improperly inflated revenue, which resulted in Qwest overstating its financial results in violation of GAAP. As a result, the year end 1999, 2000 and 2001 statements and interim statements for those years were materially misleading and false when made.

230. Andersen violated GAAS General Standard No. 2, which requires the auditor to maintain independence in mental attitude in all matters relating to the audit.

231. Andersen violated GAAS General Standard No. 3, which requires the auditor to exercise due professional care in the performance of the audit and preparation of the audit report.

232. Andersen violated GAAS Field Standard No. 1, and the standards set forth in AICPA Auditing Standards ("AU") sections 310, 320, 327, and others, by failing to adequately plan its audit and properly supervise the work of assistants so as to establish and carry out procedures reasonably designed to search for and detect the existence of errors and irregularities which would have a material effect upon the financial statements.

233. Andersen violated GAAS Field Standard No. 2, which requires the auditor to make a proper study of existing internal controls, including accounting, financial and managerial controls, to determine whether reliance thereon is justified, and if such controls are not reliable, to expand the nature and scope of the auditing procedures to be applied.

234. Andersen violated GAAS Reporting Standard No. 1, which requires the audit report to state whether the financial statements are presented in accordance with GAAP, as Andersen's audit opinion falsely represented that the Qwest financial statements complied with GAAP.

235. Andersen violated Auditing Standard AU section 230.07, which requires the auditor to plan and perform its examination of the financial statements with professional skepticism.

236. Andersen violated Auditing Standard AU section 316.25, which sets forth the steps an auditor should take upon suspecting accounting irregularities.

237. Andersen violated Auditing Standard AU section 341.02, which requires the auditor to evaluate and report on the company's ability to continue as

a going concern, including whether there is a substantial doubt about the company's ability to continue as a going concern for a reasonable period of time.

238. Andersen violated Auditing Standard AU section 722.21, which requires the auditor to ensure that the audit committee of the board of directors is aware of, and responds appropriately to, any irregularities that the auditor discovers as part of a review of interim financial information to be filed with a regulatory agency, such as the SEC.

239. Andersen violated APB 20 because it allowed Qwest, in 2000, to change its method of accounting for directory service revenues by changing the length of the terms on the directories without disclosing the change of accounting. Under APB 20, when Qwest made this change, it was required to add a footnote to its financial statement disclosing the change, the reason for the change, the class of assets affected by the change and the effect on the current and prior year's income as a result of the change.

VIII. CAUSES OF ACTION

FIRST CAUSE OF ACTION

(Violation of California Corporations Code § 25400 *et seq.*)

240. Plaintiff hereby realleges and incorporates by reference each of the foregoing paragraphs as though fully set forth herein and further alleges as follows.

241. Defendants, and each of them, acting individually and pursuant to a scheme and conspiracy, directly and indirectly, induced the purchase and retention of the notes and stocks by the Plaintiff by circulating or disseminating, in or from California, information to the effect that Qwest was a successful, growing corporation and falsely reporting the profits of Qwest for the purpose of inducing Plaintiff to purchase and hold the notes and stocks. Defendants knew or had reason to believe that their statements were false or misleading in light of the circumstances under which they were made. As a result of the misrepresentations,

Defendants knew that investors would be misled and would purchase Qwest notes and stock based upon false information. Despite this knowledge, Defendants continued to make the misrepresentations in order to induce investors to purchase Qwest notes and stock.

242. Defendants, and each of them, are liable under Corporations Code Section 25500 for wilfully participating in acts or transactions in violation of Corporations Code Section 25400, and thus are liable to Plaintiff, which purchased its notes and stock at a price which was affected by Defendants' acts, for damages sustained by Plaintiff as a result of such acts or transactions.

243. As a direct and proximate result of the wrongful conduct of Defendants and each of them, Plaintiff has sustained economic losses and other general and special damages, including pursuant to Section 25500, the economic damages as measured by the difference between the price at which Plaintiff "sold" its notes and stock and their true value in an amount to be determined according to proof at the time of trial.

244. Plaintiff is entitled to an award of prejudgment interest at the legal rate on their economic damages, pursuant to Section 25500.

WHEREFORE, Plaintiff prays for relief as set forth below.

SECOND CAUSE OF ACTION

(Violation of California Business & Professions Code §17200 *et seq.*)

245. Plaintiff incorporates and realleges each of the foregoing paragraphs, as though fully set forth herein and further alleges as follows.

246. Defendants have engaged in unfair competition within the meaning of California Business & Professions Code § 17200 *et seq.*, because Defendants' conduct is fraudulent, unfair and illegal as herein alleged. Defendants' conduct was substantially injurious to Plaintiff by virtue of the losses suffered by Plaintiff.

247. The Defendants' business acts and practices, as alleged herein, constituted and constitute a continuous and continuing course of conduct of unfair

competition by means of unfair, unlawful and/or fraudulent business acts or practices within the meaning of the foregoing statute, including, but in no way limited to, the following:

a. the violation of securities laws as set forth above are unlawful;

b. Defendants' business acts and practices, are unfair in that they induced Plaintiff to purchase and retain the notes and stocks based upon false, misleading statements disseminated by Defendants with full knowledge that the statements were false and misleading.

248. Defendants' business acts and practices, as alleged herein, have caused Plaintiff to purchase and retain the notes and stocks and suffer losses as a result thereof.

249. Plaintiff is entitled to relief, including full restitution and/or disgorgement of all revenues, earnings, profits, compensation and benefits which may have been obtained by Defendants as a result of such business, acts or practices, and enjoining Defendants to cease and desist from engaging in the practices described herein.

WHEREFORE, Plaintiff prays for relief as set forth below.

THIRD CAUSE OF ACTION

(Fraud, Deceit and Concealment)

250. Plaintiff incorporates and realleges each of the foregoing paragraphs, as though fully set forth herein and further alleges as follows.

251. Defendants, and each of them, made material representations and omissions to Plaintiff which were false and misleading, including but not limited to those representations and omissions as to the financial condition of Qwest and its prospects for continued growth. These material misrepresentations and omissions are contained in and reflected in the registration statements, as well as press releases, public statements, financial statements, and other disclosures made

by Defendants which support and reinforce the misrepresentations and omissions in the registration statements.

252. These representations were false in that the financial statements were not prepared in accordance with GAAP. Because of the fraudulent accounting, the financial statements showed inflated revenues for 1999, 2000 and 2001.

253. When Defendants, and each of them, made the representations and failed to disclose and suppressed information they had a duty to disclose, as set forth hereinbefore, Defendants had knowledge of the falsity of their statements and representations and knew that they were failing to disclose material facts which they had a duty to disclose.

254. Defendants made the misrepresentations and omitted the material facts with the intent to defraud Plaintiff and to induce Plaintiff to invest in Qwest notes and stock.

255. At the time these misrepresentations were made and the material facts not disclosed, and at the time that Plaintiff took the actions herein alleged, Plaintiff was ignorant of the true facts. If Plaintiff had known the true facts, it would not have invested in Qwest notes and stock.

256. Plaintiff reasonably relied on these representations in investing in Qwest and its reliance was justified since the Defendants concealed the true facts.

257. The Defendants knew that a fraud was occurring in the representations about Qwest's financial statements. Notwithstanding their knowledge of this improper and unlawful conduct, these Defendants, and each of them, engaged in conduct, hereinbefore described which rendered substantial assistance to, encouraged and/or aided and abetted the fraud.

258. With knowledge of the unlawful purpose of the fraud, Defendants, and each of them, entered into an agreement to accomplish the aforesaid scheme, and by their actions took steps to further that scheme.

259. As a direct and proximate result of the wrongful conduct of each of the Defendants, Plaintiff has suffered and will continue to suffer economic losses and other general and specific damages, all in an amount to be determined according to proof.

260. The aforementioned acts of Defendants, and each of them, were done maliciously, oppressively, and with intent to defraud, and Plaintiff is entitled to punitive and exemplary damages in an amount to be shown according to proof at the time of trial.

FOURTH CAUSE OF ACTION

(Breach of Fiduciary Duty)

261. Plaintiff incorporates and realleges each of the foregoing paragraphs, as though fully set forth herein and further alleges as follows.

262. By virtue of Plaintiff's ownership of the notes and stock that are the subject of this Complaint, the Defendants, and each of them, owed fiduciary duties of the highest good faith, integrity and fair dealing to Plaintiff as holders of the notes and stocks. Defendants, and each of them, further owed fiduciary obligations to Plaintiff as Defendants sought to induce and did induce Plaintiff to purchase the notes and stock.

263. Defendants and each of them, had insider knowledge of adverse non-public information regarding the notes and stock as alleged above. Defendants knowingly and intentionally concealed this adverse non-public information from the Plaintiff.

264. Defendants, and each of them, breached and violated their fiduciary obligations to Plaintiff, to the detriment of Plaintiff, by failing to disclose all material information known to Defendants at the time that Plaintiff purchased the notes and stocks, and by making the above-mentioned misrepresentations to induce Plaintiff to purchase the notes and stocks or to take other actions.

265. As set forth above, the Defendants knew that Qwest was engaged in fraudulent conduct, and that Qwest was breaching its fiduciary duty to its shareholders. Notwithstanding their knowledge of the improper and unlawful conduct, the Defendants, and each of them, engaged in conduct, hereinbefore described which rendered substantial assistance to, encouraged and/or aided and abetted the breach of fiduciary duty.

266. With knowledge of the unlawful purpose of the conduct of Qwest, the Defendants, and each of them, entered into an agreement to accomplish the aforesaid scheme, and by their actions took steps to further that scheme.

267. As a result of the wrongful conduct of each of the Defendants, Plaintiff has suffered and will continue to suffer economic losses and other general and specific damages, all in an amount to be determined according to proof.

268. The aforementioned acts of Defendants, and each of them, were done maliciously, oppressively, and with intent to defraud, and Plaintiff is entitled to punitive and exemplary damages in an amount to be shown according to proof at the time of trial.

WHEREFORE, Plaintiff prays for relief as set forth below.

FIFTH CAUSE OF ACTION

(Against Andersen for Violations of Section 11 of the Securities Act)

269. Plaintiff incorporates and realleges each of the foregoing paragraphs, but excluding any allegation of fraudulent intent, as though fully set forth herein and further alleges as follows.

270. This claim is brought against Defendant Andersen pursuant to Section 11 of the Securities Act. This claim does not sound in fraud, and neither fraud nor scienter is an element of this claim.

271. Andersen was an accounting firm retained by Qwest to, among other things, audit Qwest's fiscal 1999, 2000, and 2001 financial statements. Pursuant

to that retention, Andersen issued unqualified opinions validating Qwest's financial statements for fiscal years 1999, and 2000.

272. Andersen expressly consented to having its unqualified audit opinions incorporated into the registration statements for the Qwest notes and to being named as independent public accountant in the registration statement filed June 21, 1999 for Qwest's issuance of common stock to fund its stock purchase of U S West. As such, Andersen expressly consented to serving as an accounting "expert" with respect to the offering of the Qwest notes and stock.

273. The notes were purchased and the stock acquired by Plaintiff pursuant to or traceable to the registration statements.

274. Andersen's unqualified opinions on Qwest's 1999, 2000 and 2001 financial statements were materially false and misleading. Contrary to its representations, Andersen's audit of those financial statements had not been conducted in accordance with GAAP, and Qwest's financial condition and results of operations had not been presented in conformity with GAAP, as set forth above. Instead, Qwest's audited year-end 1999, 2000 and 2001 financial statements contained untrue statements of material facts and failed to state other facts necessary to make the statements not misleading, and were in violation of GAAP.

275. As an accounting expert which consented to the use of its unqualified audit opinions in the registration statements, Andersen is liable under Section 11 of the Securities Act for the material misrepresentations or omissions contained in its unqualified audit opinion and in Qwest's financial statements included in the registration statements. Andersen did not make a reasonable investigation and did not possess reasonable grounds for believing that its representations in its audit opinions and Qwest's financial statements were true, did not omit any material facts, and were not materially misleading.

276. Plaintiff did not know or in the exercise of reasonable diligence could not have known of the misstatements and omissions of material fact contained in the registration statements.

277. Plaintiff has suffered damages as a result of the misstatements and omissions of material fact contained in the registration statements for which it is entitled to compensation.

WHEREFORE, Plaintiff prays for relief as set forth below.

SIXTH CAUSE OF ACTION

(Against Certain Bank Defendants for Violations of Section 11 of the Securities Act)

278. Plaintiff incorporates and realleges each of the foregoing paragraphs, but excluding any allegation of fraudulent intent, as though fully set forth herein and further alleges as follows.

279. Plaintiff purchased notes underwritten by Salomon, Lehman, Morgan Chase, Banc of America and Merrill, and this claim is brought against them pursuant to Section 11 of the Securities Act. This claim does not sound in fraud, and neither fraud nor scienter is an element of this claim.

280. These Bank Defendants served as the underwriters of the notes under the definition contained in Section 2(a)(11) of the Securities Act, 15 U.S.C. § 77b(a)(11). As such, they participated in the solicitation, offering, and sale of the notes to the investing public pursuant to the registration statements for the notes. Plaintiff purchased or acquired the notes pursuant to, or traceable to, the registration statements.

281. The registration statements, at the time they were issued and became effective, were inaccurate and misleading, contained untrue statements of material fact and/or omitted to state material facts necessary to make the statements made therein not misleading, as set forth above. The matters detailed above would have

been material to a reasonable person reviewing the registration statements and the financial statements incorporated therein.

282. Due to their role as underwriters of the Qwest Notes, the Bank Defendants were responsible for the contents and dissemination of the registration statements and are liable under Section 11 of the Securities Act for any material misrepresentations or omissions contained therein. The Bank Defendants did not make a reasonable investigation and did not possess reasonable grounds for believing that the statements contained in the registration statements were true, did not omit any material fact, and were not materially misleading.

283. Plaintiff did not know or in the exercise of reasonable diligence could not have known of the misstatements and omissions of material fact contained in the registration statements.

284. Plaintiff has sustained damages as a result of the misstatements and omissions of material fact contained in the registration statements for which Plaintiff is entitled to compensation.

285. Each of the Bank Defendants owed the purchasers of the Qwest notes, including Plaintiff, the duty to make a reasonable and diligent investigation of the statements contained in the registration statements at the time they became effective, to ensure that they were true and that there was no omission to state a material fact required to be stated in order to make the statements contained therein not misleading. In the exercise of reasonable care, the Bank Defendants knew or should have known of the material misstatements and omissions contained in the Registration Statements.

WHEREFORE, Plaintiff prays for relief as set forth below.

SEVENTH CAUSE OF ACTION

(Against certain Individual Defendants for Violations of Section 11 of the Securities Act)

286. Plaintiff incorporates and realleges each of the foregoing paragraphs, but excluding any allegation of fraudulent intent, as though fully set forth herein and further alleges as follows.

287. Plaintiff purchased Qwest notes and acquired Qwest stock issued pursuant to a registration statement. Plaintiff purchased or acquired these securities pursuant to, or traceable to, registration statements signed by or on behalf of Individual Defendants Nacchio, Anschutz, Woodruff, Szeliga, Barrett, and/or Khosla, or which identified those individuals as directors of Qwest.

288. This claim is brought against these Individual Defendants pursuant to Section 11 of the Securities Act. This claim does not sound in fraud, and neither fraud nor scienter is an element of this claim.

289. The registration statements, at the time they was issued and became effective, were inaccurate and misleading, contained untrue statements of material fact and/or omitted to state material facts necessary to make the statements made therein not misleading, as set forth above. The matters detailed above would have been material to a reasonable person reviewing the registration statements and the financial statements incorporated therein.

290. These Individual Defendants were responsible for the contents and dissemination of the registration statements and are liable under Section 11 of the Securities Act for any material misrepresentations or omissions contained therein. These Individual Defendants did not make a reasonable investigation and did not possess reasonable grounds for believing that the statements contained in the registration statements were true, did not omit any material fact, and were not materially misleading.

291. Plaintiff did not know or in the exercise of reasonable diligence could not have known of the misstatements and omissions of material fact contained in the registration statements.

292. Plaintiff has sustained damages as a result of the misstatements and omissions of material fact contained in the registration statements for which they are entitled to compensation.

293. Each of these Individual Defendants owed the purchasers of the Qwest notes and stock, including Plaintiff, the duty to make a reasonable and diligent investigation of the statements contained in the registration statements at the time they became effective, to ensure that they were true and that there was no omission to state a material fact required to be stated in order to make the statements contained therein not misleading. In the exercise of reasonable care, these Individual Defendants knew or should have known of the material misstatements and omission contained in the registration statements. Moreover, these Individual Defendants knew of the misconduct of the other Defendants and failed to advise the Plaintiff of this misconduct.

WHEREFORE, Plaintiff prays for relief as set forth below.

EIGHTH CAUSE OF ACTION

(For Violations of Section 15 of the Securities Act of 1933)

294. Plaintiff incorporates and realleges each of the foregoing paragraphs, but excluding any allegation of fraudulent intent, as though fully set forth herein and further alleges as follows.

295. Plaintiff asserts this cause of action against Defendants Nacchio and Anschutz under Section 15 of the Securities Act. This claim does not sound in fraud, and neither fraud nor scienter is an element of this claim.

296. These two Defendants, by reason of their management positions, membership or representations on Qwest's board of directors, or stock ownership, were controlling persons within the meaning of Section 15 of the Securities Act,

15 U.S.C. § 77o. These Defendants had power, influence and control, and exercised it to cause Qwest to engage in the violations of law complained of herein.

297. Accordingly, Defendants Nacchio and Anschutz are liable under Section 15 of the Securities Act.

298. As a result of Defendants' wrongdoing, Plaintiff has suffered damages, in an amount to be determined at trial.

WHEREFORE, Plaintiff prays for relief as set forth below.

IX. PRAYER FOR RELIEF

1. Compensatory and general damages according to proof;
2. Special damages according to proof;
3. Restitution according to proof;
4. Prejudgment interest at the maximum rate;
5. Punitive and exemplary damages according to proof;
6. Costs of the proceedings herein;
7. Reasonable attorneys fees; and
8. All such other and further relief as the Court deems just and proper.

Dated: December 10, 2002 **COTCHETT, PITRE, SIMON & McCARTHY**

By: /S/
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Dated: December 10, 2002

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JURY DEMAND

Plaintiff demands a jury trial on all issues so triable.

Dated: December 10, 2002

COTCHETT, PITRE, SIMON & McCARTHY

By: /S/

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